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On 1 October, 1991 the Department of Defense implemented the Defense Management Review Decisions (DMRDs) in an effort to reorganize the supply system and reduce overall costs. These changes were implemented without regard for the Foreign Military Sales (FMS) program. This paper analyzes the changes forced on the FMS program since implementation of the DMRD initiatives and evaluates those changes in terms of the legislative requirement for cost recovery and effect on customer service. An analysis of the rates assessed FMS customers to use the Defense Transportation System is performed and are compared to the actual charges being billed to the FMS transportation trust fund account. An alternate transportation pricing model is reviewed for applicability and recommendations are made for changes to the FMS transportation pricing policy.

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Transportation Pricing Policy for the Foreign Military Sales Programs

by

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Lieutenant Commander, United States Navy
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of the requirements for the degree of

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ABSTRACT

On 1 October, 1991 the Department of Defense implemented the Defense Management Review Decisions (DMRDs) in an effort to reorganize the supply system and reduce overall costs. These changes were implemented without regard for the Foreign Military Sales (FMS) program. This paper analyzes the changes forced on the FMS program since implementation of the DMRD initiatives and evaluates those changes in terms of the legislative requirement for cost recovery and effect on customer service. An analysis of the rates assessed FMS customers to use the Defense Transportation System is performed and are compared to the actual charges being billed to the FMS transportation trust fund account. An alternate transportation pricing model is reviewed for applicability and recommendations are made for changes to the FMS transportation pricing policy.

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I. INTRODUCTION

A. OVERVIEW

Security assistance, one of the primary methods used to carry out our foreign and national security policy, is the transfer of defense articles, defense services, military training, and economic assistance to allied and friendly foreign countries. These programs have been provided on the premise that the security and economic well-being of friendly foreign countries is essential to U.S. security.

During the last three years, the world's geopolitical landscape has changed dramatically. The Berlin Wall, long a symbol of the differences between the United States (U.S.) and our Western allies, on one hand, and the Soviet Warsaw Pact countries, on the other, was torn down, and a new age of world politics began. East and West Germany were reunited and the old Soviet satellite states opened their doors to freedom without the fear of the Russian Bear who had always kept a tight reign on their people. President Bush talked about a "new world order" of mutual cooperation now possible without two superpowers threatening each other with nuclear annihilation. Politicians in the U.S. have hailed the victory in the Cold War and immediately began calling for reductions in the Department of Defense (DOD) budget, a peace dividend

that could be reaped, since the U.S. no longer required a force to combat the Soviet Union.

While the U.S. forces are downsizing, the need for adequate security assistance is just as important today as it was at the height of the Cold War. The reduced tensions in the European theater do not automatically result in reduced security problems in other regions of the world, which the Desert Storm conflict has made apparent. The disintegration of the Warsaw Pact and instability in the Soviet Union could, in fact, contribute to greater regional security problems. The U.S security assistance programs have always been directed toward balancing regional powers and ensuring regional stability. The passing of the Cold War could entail greater responsibility for us and an increased need for security assistance. [Ref. 1]

The reality of a weakened, if not totally disabled, major adversary has meant significant budget cuts and policy changes to the DOD. One of the major policy changes has been the implementation of the Defense Management Review Decisions (DMRDs). The DMRD initiatives are aimed at reorganizing DOD forces, including the supply system, to reduce overall costs by $30 billion for the period FY 91-95. Several DMRDs have had a direct impact on the largest of the security assistance programs, Foreign Military Sales (FMS). Specifically, DOD implemented DMRD 901 which reorganized the financing of supply operations to save approximately 7 billion dollars in supply

system costs between 1991 and 1995. This change affected the stock fund, the revolving account that procures material for stock, or ready availability, and is refunded by the DOD or FMS purchaser when material is requisitioned. Since implementation of DMRD 901 in October 1991, FMS prices for stock funded material have increased from 23% to 39% taking FMS customer countries quite by surprise. [Ref. 2]

B. STATEMENT OF PROBLEM

Before DMRD 901, FMS customers had been paying additional surcharges that supposedly reimbursed the United States Government (USG) for all costs associated with the transaction as required by FMS legislation, which dictates no profit or loss will be taken on FMS. If the USG was not making a profit or taking a loss on FMS transactions as required by Congressional legislation before DMRD 901, why did the price of stock funded material increase so dramatically after implementation? One reason can possibly be found in how the USG was previously charging FMS customers for transportation services and possibly subsidizing the FMS program.

When a customer country uses the Defense Transportation System (DTS) to ship material, the surcharges for the transportation service are determined in one of two ways. They are derived either by a straight surcharge based on a percentage of the unit cost of the item or by using what is called the Transportation Cost Look-up Table. The purpose of

the table is to provide an estimate of the actual transportation charges for hazardous or sensitive items, such as missiles, that are normally shipped by the DTS. It was developed for items whose transportation charges using standard transportation percentages differed significantly from the actual transportation cost.

In March of 1992 the DOD Inspector General completed an audit of how accurate DOD was in the applying accessorial surcharges to FMS for the recovery of transportation costs. Their findings reported that FMS customers had been overcharged by $2.3 million for transportation costs on 19 cases and undercharged by $2 million on 13 other cases. The main reasons for the discrepancies were administrative errors, such as not using the look-up table properly or not reporting when delivery methods were changed.

The audit, however, did not review whether the transportation charges assessed the FMS customers were in line with the actual cost of using the DTS as per the legislative and regulatory requirements. Additionally, the Air Force, in their reply to the audit findings, stated that while they agreed in theory with the use of the cost look-up table to determine transportation charges, the table concept is "somewhat of a dinosaur in a high-tech age".[Ref. 3]

In addition to problems with the transportation cost look-up table, the implementation of the DMRD initiatives has been anything but a smooth transition for FMS transportation

operations. One of the major changes brought on by DMRD 901 has been the USG's assumption of responsibility for second destination transportation for stock funded material. Second destination transportation is movement of material from point of issue to the customer's freight forwarder. This was previously the responsibility of the FMS customers, who had the option of which commercial carrier they would use based on price and services provided. The new change has resulted in freight forwarder complaints, increased misdirected shipments, and very dissatisfied FMS customers.[Ref 4]

The FMS transportation trust fund, controlled by the Security Assistance Accounting Center (SAAC), has also been losing money since the implementation of the DMRDs. This trust fund is a revolving account that collects monies charged to FMS customers for transportation services based on assessment fees and pays the individual Military Departments (MILDEPS) for actual transportation services performed. Before Oct 1, 1991, the account had a surplus of over 100 million dollars. In a little less than one year since implementation of DMRD 901, the surplus has been depleted.[Ref. Ruth] This would indicate that the FMS transportation program is operating at a loss.

C. OBJECTIVE OF RESEARCH

The principal objective of this research is to analyze the current Defense Security Assistance Agency (DSAA) FMS

transportation policy in light of the recent changes made by the implementation of the DMRD initiatives and evaluate that policy in terms of the legislative requirements for cost recovery. Additionally, this research will analyze the rates assessed FMS customers to use the Defense Transportation System and compare them with the actual charges being billed to the FMS transportation trust fund account. Alternate transportation pricing models will be reviewed for applicability to the FMS program.

D. RESEARCH METHODOLOGY

Research data was collected through various methods. Telephone interviews were conducted with key personnel at Naval Supply Systems Command, Washington, D.C.; Navy International Logistics Control Office, Philadelphia, PA; Navy International Programs Office, Washington, D.C.; Defense Security Assistance Agency, Washington, D.C.; Security Assistance Accounting Center, Denver, CO; and Defense Depot Region West, Oakland, CA.

E. SCOPE OF THESIS

This thesis is a review of the transportation pricing policies of the FMS program and an evaluation of that policy in terms of legislative requirements for cost recovery and the customer service provided under that policy. Alternate

transportation pricing models are reviewed for applicability to the FMS program.

F. THESIS ORGANIZATION

To provide a basic knowledge of the development of FMS, Chapter II provides a historical and organizational synopsis of the FMS program. Since there is no separate, dedicated logistics system for FMS shipments, a review of the modifications DOD has employed to provide and move FMS material within the existing DOD logistics organization is also discussed. Additionally Chapter II reviews the implementation of the Defense Management Review Decisions and their impact on the FMS program. Current legislative guidance and DOD pricing policies for FMS transactions is also examined.

Chapter III provides a general description of the financial administration of FMS. The strengths and weaknesses of the transportation pricing model are reviewed as well as the accuracy of transportation charges assessed to FMS customers. The transportation cost look-up table is also examined for its accuracy in assessing transportation charges for high cost items.

Chapter IV identifies an alternate transportation pricing model favored by the Office of the Secretary of Defense (OSD) and reviews the strengths and weaknesses in terms of

implementation, legislative requirements, and customer service.

In summary, this research examines the current DSAA transportation pricing model that has evolved from the new cost cutting initiatives and an alternate pricing model is reviewed for possible future application. Conclusions and recommendations are specifically addressed in Chapter V.

II. FMS BACKGROUND, ORGANIZATION AND OPERATIONS

A. BRIEF HISTORY OF THE FMS PROGRAM

Since World War II the United States has been formally assisting friendly nations in establishing and maintaining adequate defense capabilities for internal security and external border threats. This assistance has been provided on the basic premise that the economic well-being and security of friendly foreign countries is essential to U.S. security. Assistance has been provided in a variety of ways, including the sale of defense articles and services, economic aid and military training. As the marked ideological differences between the Soviet Union and the U.S. during the "cold war" became increasingly apparent, the U.S. political philosophy of protecting its national interests was emphasized with increasing importance being placed on FMS.

The Truman Doctrine, formulated in 1947 in response to concern over aggressive acts by guerilla communists in Greece and by Soviet diplomatic pressures in Turkey, was underscored by President Truman's request for aid to both countries. [Ref. 5:p. 25] Congress passed Public Law 75 which brought the benefits of economic and military assistance to Greece and Turkey. Thus began the important role security assistance plays in U.S. foreign policy.

In the 1950s, under the Mutual Security Acts of 1951 and 1954, security assistance consisted mainly of transferring surplus military equipment through grants-in-aid or loans. [Ref. 5:p. 27] In the early 1960s, the mostly grant aid security assistance program changed significantly due to several factors: the depletion of World War II stock, the concern over the international communist movement, an unfavorable trend in the balance of payments, and the increasing capability of some allies to financially support their own defense programs. These changes lead to the passing of the Foreign Assistance Act (FAA), of 1961. Government agencies that furnished assistance were to be reimbursed from funds available under this act in an amount equal to the value of the articles or services. In 1962, the FAA was changed to read that reimbursement value shall not be less than the value of the articles or services, which provides the current legislative basis for reimbursable export foreign military sales as well as how security assistance was to be administered. [Ref. 6:p. 48]

Foreign military sales escalated during the 1960s when the direction of security assistance changed from grant military aid to reimbursable foreign military sales. [Ref. 5:p 31] With this growth in sales (see Figure 1), the cost recovery efforts grew in importance. In 1968 Congress passed the Foreign Military Sales Act which separated FMS from other foreign assistance programs and consolidated the

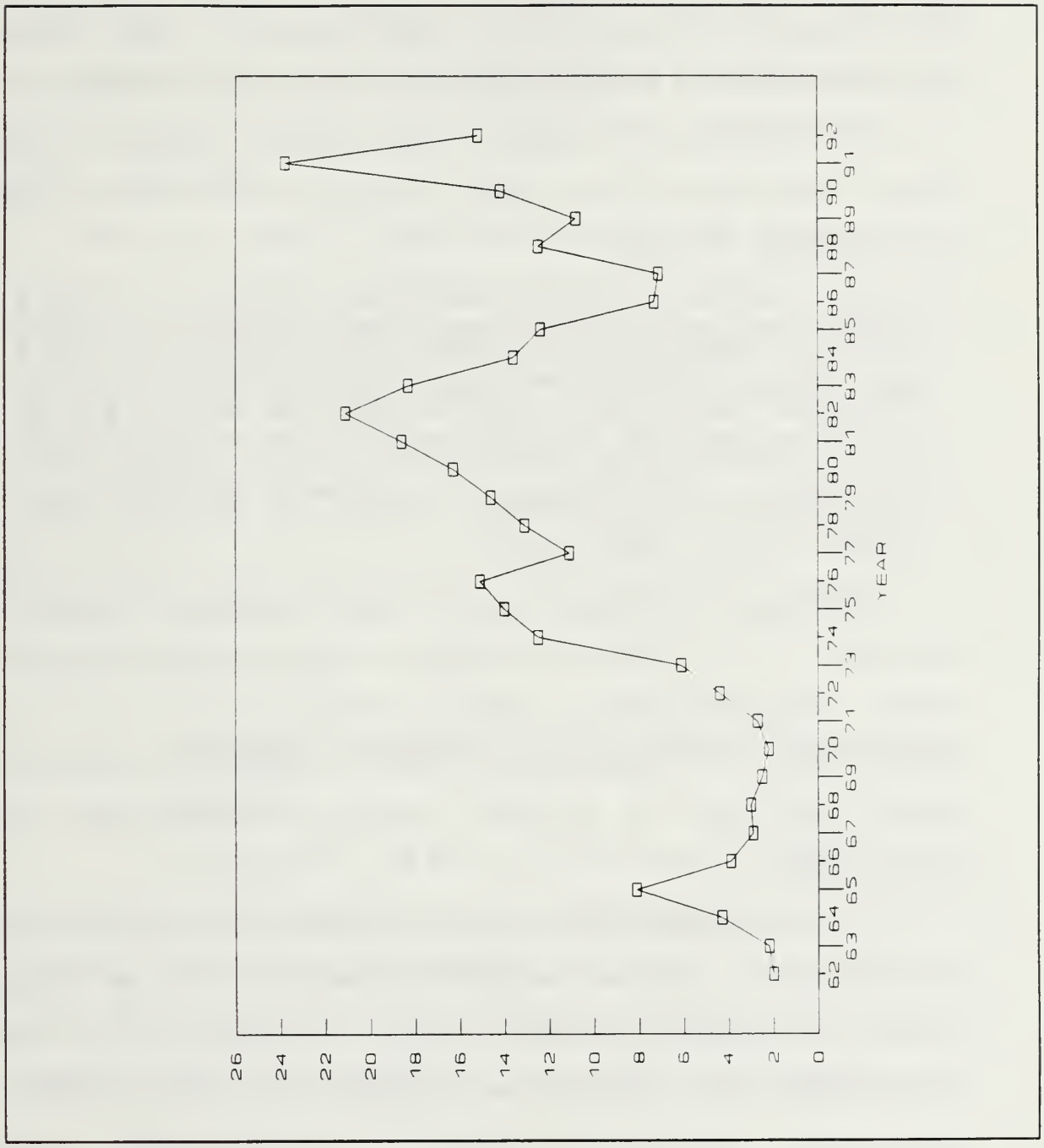

Figure 1 Total DOD Foreign Military Sales (Billions)
Source: Naval Supply Systems Command

administration and legislative authority dealing with FMS to meet the growing demands of an expanding program. The new act also reemphasized that the U.S. would receive no less than the value of materials and services sold to foreign governments.

This legislative viewpoint was further defined by the General Accounting Office (GAO) in their 1978 review of FMS cost recovery efforts.

> Although neither the FAA (Foreign Assistance Act) nor its legislative history defines value as it relates to defense services, we believe that the FAA contemplates recovery of full costs for defense services which are sold to foreign customers. We believe therefore that the selling prices for defense services should be established on the basis of the full cost pricing method... Full cost pricing would establish a selling price for defense services that recovers all costs incurred, whether of a direct or an indirect nature.[Ref. 7:p. 7]

Increasing congressional attention focused on the dramatic increase in the volume of foreign military sales during the 1970s. The rapid growth, from $1.2 billion in FY-70 to $13.9 billion in FY-75, dramatized the need for adequate measures to recoup the value of military hardware and services sold through FMS.

In 1976 Congress took action to strengthen FMS procedures. The FMS act of 1968 was amended and renamed the Arms Export Control Act (AECA). Through this act, Congress clarified and strengthened cost recovery and pricing policies of FMS by authorizing appropriate charges for administrative costs, accessorial costs (packing, crating, handling, transportation) and non-recurring costs such as production and research and

development. The main reason for this change was to ensure FMS transactions included not only direct costs but a fair share of indirect costs as well. Security assistance appropriations are included yearly in the "Foreign Operations, Export Financing and Related Programs Appropriation Act". [Ref. 8:p. 33]

Both the FAA of 1961 and the AECA are amended by the annual or biennial security assistance authorization act, e.g., the International Security and Development Cooperation Act of (year). However, since 1976 there has not been any major change to the legislation. This does not reflect, however, a lack of interest in the security assistance area by Congress, as evidenced by their earmarking of 98% of the foreign assistance funds for specific countries, which is up from 45% in 1976.[Ref. 9:p. 4]

B. U.S. GOVERNMENT ORGANIZATIONS FOR SECURITY ASSISTANCE

1. President

The President, as chief of the executive branch of the government, has the constitutional responsibility for carrying out the laws enacted by Congress and is the chief arbiter in matters of foreign policy. Figure 2 identifies the chain of command within this branch in the security assistance area.

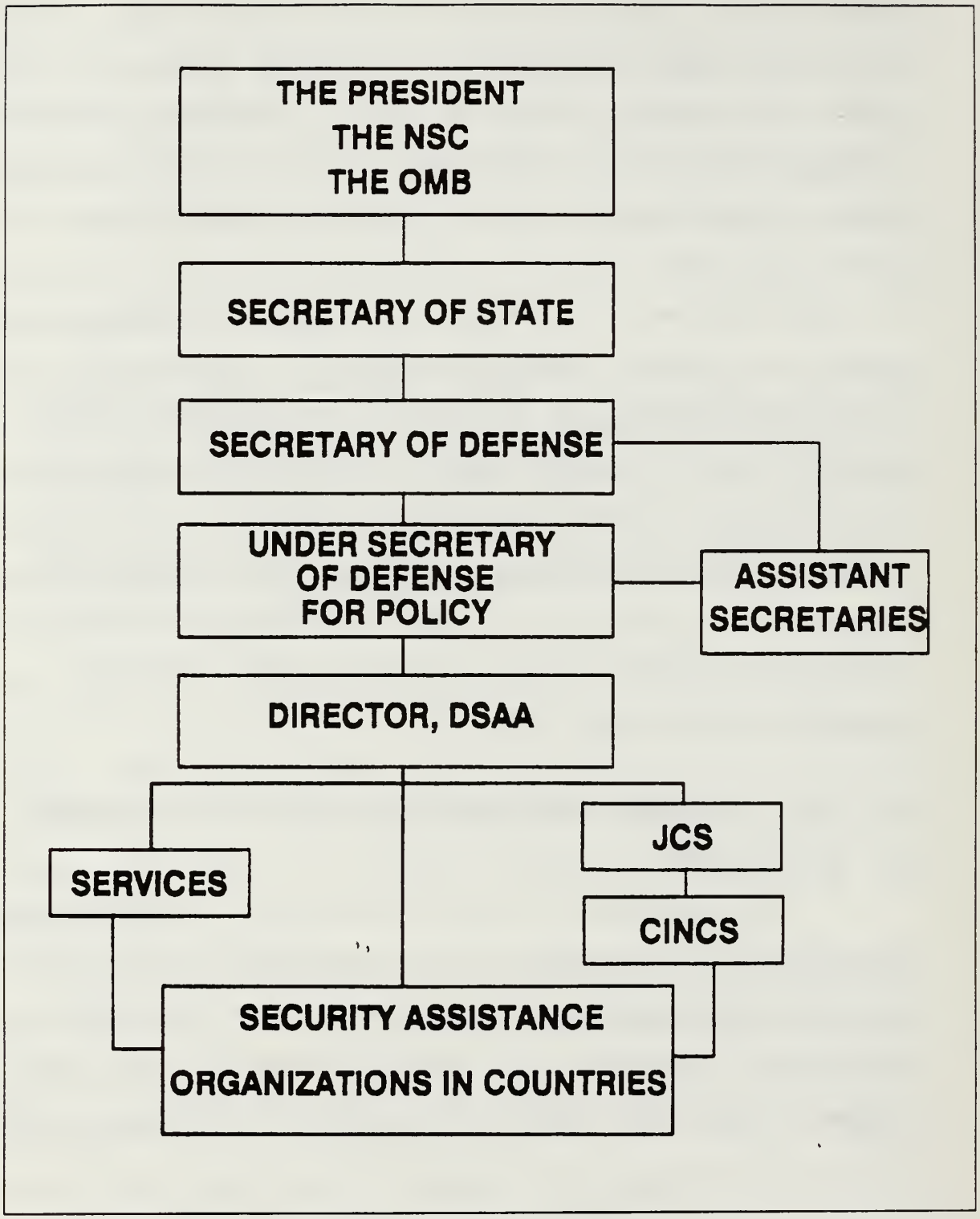

Figure 2 Executive Branch Organizations Involved in Security Assistance

Source: Management of Security Assistance

With the foreign policy responsibility comes the authority for determining the security assistance programs to be developed for individual foreign countries. This authority is normally delegated to the Department of State.

2. Department of State

The Department of State is responsible to the President for determining the security assistance programs for individual foreign countries that support the foreign policy of the President. The responsibilities of the Secretary of State for security assistance and sales are set forth in the Foreign Assistance Act of 1961, as amended, and in the Arms Export Control Act of 1976. These acts provide that under the direction of the President, the Secretary of State shall be responsible for:

a. The continuous supervision and general direction of economic assistance, military assistance, military education and training, and sales and export programs;

b. Determining whether there shall be a security assistance program, or a sale to, lease to, or financing for a country and the value thereof;

c. Determining whether there will be a cooperative project, and the scope thereof;

d. Determining whether there will be a delivery or other performance under the sale, lease, cooperative project, or export; and

e. Insuring such programs are effectively integrated both at home and abroad, and that the foreign policy of the United States is best served thereby. [Ref. 8:P. 77]

3. Department of Defense

The Department of Defense is responsible to the Department of State for executing the security assistance programs determined appropriate by the Department of State. The Foreign Assistance Act of 1961, as amended, charges DOD with the following international logistic responsibilities.

a. Determination of military end-item requirements.

b. Procurement of military equipment in a manner which permits its integration with service programs.

c. Supervision of end-item use by recipient countries.

d. Supervision of the training of foreign military personnel.

e. Movement and delivery of military end-items.

f. Any other functions within the Department of Defense with respect to the furnishing of military assistance. [Ref. 8:P. 87]

4. Defense Security Assistance Agency

The Defense Security Assistance Agency (DSAA) is the principal organization through which the Secretary of Defense carries out his responsibilities for security assistance. Established as a separate agency of the DOD, DSAA falls under the direction, authority, and control of the Under Secretary of Defense for Policy and receives policy direction and staff supervision from the Assistant Secretary of Defense/Internal Security Affairs (ASD/ISA). The DSAA serves as the DOD focal point and clearinghouse for tracking arms transfers,

budgetary, legislative and other security assistance matters. DSAA responsibilities include:

a. Administration and supervision of security assistance planning and programs.

b. Coordination of the formulation and execution of security assistance programs with other governmental agencies.

c. Conducting international logistics and sales negotiations with foreign countries.

d. Serve as the DOD focal point for liaison with U.S. industry with regard to security assistance activities.

e. Managing the credit financing program.

f. Developing and promulgating security assistance procedures.

g. Developing and operating the data processing system and maintaining the data base required by all levels of management for the security assistance program.

h. Making determinations with respect to the allocation of FMS administration funds. [Ref. 8:P. 85]

5. Defense Finance and Accounting Service-Denver Center, Security Assistance (DFAS-DE/F) / Security Assistance Accounting Center (SAAC)

Before October 1976 each of the military departments individually handled all aspects of FMS transactions, including procurement, billing and collecting of funds. As previously mentioned however, FMS sales skyrocketed in the 1970s which soon overwhelmed the military departments financial management systems. Under pressure from GAO to correctly identify all costs associated with FMS and answer complaints

from customer countries about the numerous bills received from the U.S., DOD consolidated the financial management of FMS under the Security Assistance Accounting Center (SAAC). The SAAC functions have recently been consolidated under the Defense Finance and Accounting Service (DFAS), however, the title of SAAC is still maintained for continuity to our FMS customers. For this report, the office is referred to as SAAC.

Managed by the Department of the Air Force, SAAC operates the DOD centralized billing, collecting and trust fund accounting system for security assistance for all of the military departments. SAAC implements the DOD Security Assistance Financial Management Program by performing the following functions:

a. Serve as the central point of contact within DOD for all FMS related financial inquires from USG activities and foreign governments, and for procedural and operational financial inquiries from DOD components.

b. Prepare, review, and authenticate all DOD FMS bills, and calculate and assess interest due on delinquent debts.

c. Maintain a centralized, automated FMS financial data system.

d. Analyze FMS Letters of Offer and Acceptance to ensure the adequacy of financial arrangements.

e. Operate the centralized system for DOD-wide FMS forecasting, delivery reporting, billing, collecting, and trust fund management.

f. Ensure adequate interface of DOD-wide logistical and financial systems.

g. Perform trust fund accounting and monitor FMS trust fund balances to ensure adequacy of foreign countries' deposits and prompt reimbursement of DOD components' appropriations.

h. Conduct continuing analysis and necessary redesign of FMS financial systems to ensure adequacy, maximum standardization, and simplification.

i. Provide assistance and guidance to DOD components and foreign customers relative to the financial execution of the FMS Program. [Ref. 10:P. 16]

SAAC is also responsible for providing Congress, the National Security Council (NSC), and the Office of Management and Budget (OMB) with information regarding FMS program status.

6. Secretary of the Navy / Chief of Naval Operations

During 1986 there was a reorganization within the U.S. Navy Security Assistance program. Previously, CNO (OP-63) had responsibility for Navy FMS programs. After the reorganization those responsibilities were transferred to the Office of the Secretary of the Navy, or more specifically, the Navy Office of Technology Transfer and Security Assistance (NAVOTTSA). Recently, this office has been re-named the Navy International Programs Office (NAVY IPO). Figure 3 identifies the chain of command within this branch. This office is headed by a Deputy Assistant Secretary of the Navy and controls the FMS programs for the Navy, Marines, and Coast Guard. Responsibilities include negotiations with foreign governments, preparation of the sales agreement document

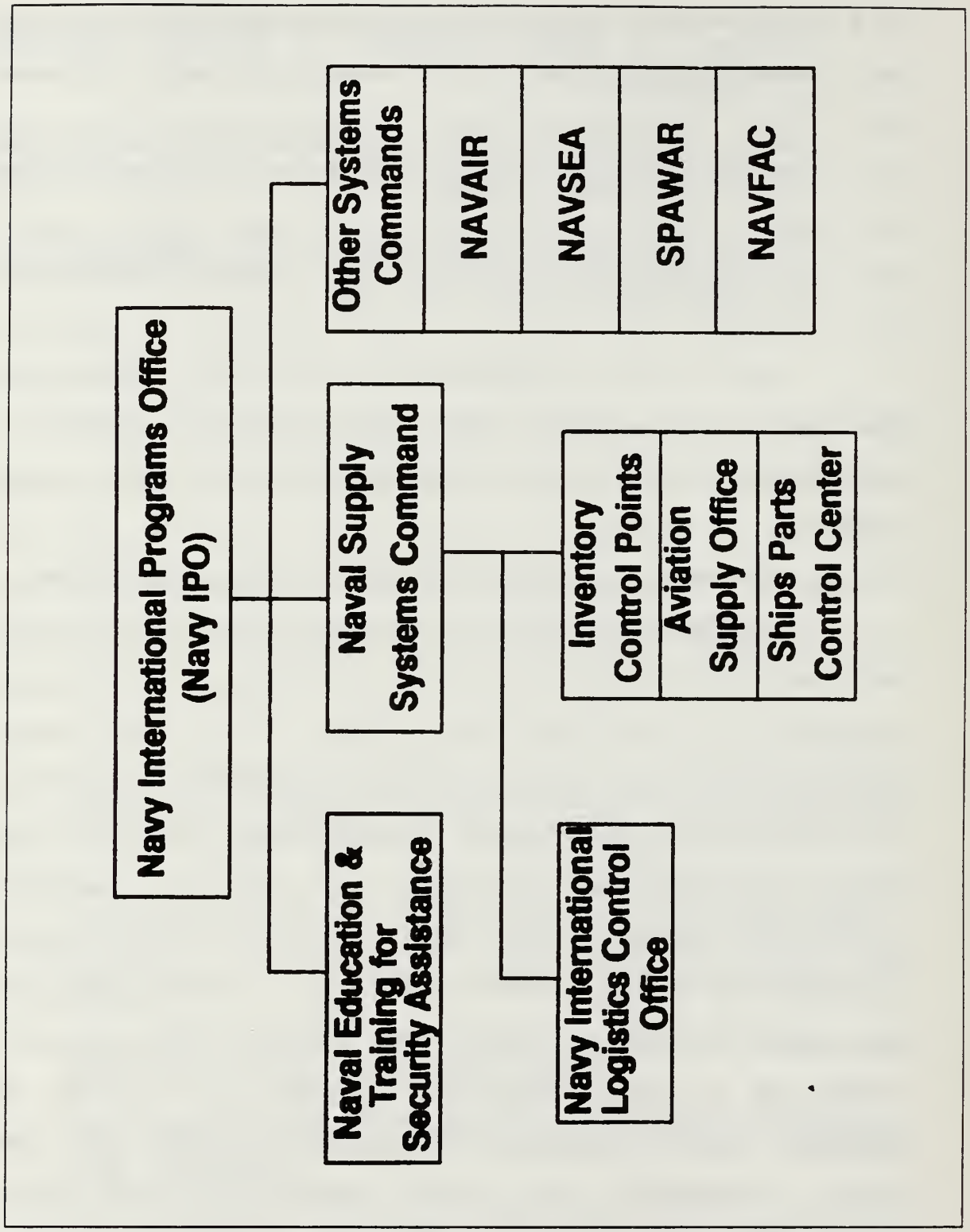

Figure 3 U.S. Navy Organization for Security Assistance
Source: The Management of Security Assistance

(DD Form 1513), the Letter of Offer and Acceptance (LOA), and various program performance and support requirements.

7. Naval Supply Systems Command

The Naval Supply Systems Command (NAVSUP) has three major areas of responsibility in the FMS Program:

a. Direct the actions of its Inventory Control Points and Navy stock points to implement FMS transactions.

b. Execute the detailed supply functions of the Navy FMS program. The day to day operations are delegated to Navy International Logistics Control Office (NAVILCO).

c. Coordinate and monitor the development and implementation of Navy FMS cases.

8. Navy International Logistics Control Office

The Navy International Logistics Control Office (NAVILCO) is the focal point within the U.S. Navy for the introduction of all Navy FMS requisitions into the Integrated Navy Supply System. Its primary function is to serve as the Navy FMS customer service representative. NAVILCO is the only major NAVSUP command that exists solely to support the Navy FMS program. NAVILCO is the FMS customer's single point of contact for Navy FMS supply matters. NAVILCO's responsibilities include:

a. Receive and verify all Navy FMS requisitions for material and forward to appropriate item manager.

b. Provide status for all outstanding Navy FMS requisitions.

c. Process FMS Reports of Discrepancy (RODS).

d. Coordinate financial controls with SAAC and assist with Navy FMS case closure.

e. Provide Navy FMS customer with Quarterly Requisition Reports (QRR) and Reply to Customer Request for Adjustments.

C. FMS CASE IMPLEMENTATION FOR SECONDARY ITEMS

In the world of FMS, a case is defined as a contractual sales agreement between the U.S. government and an eligible foreign country or international organization documented by a DD Form 1513 called the Letter of Offer and Acceptance (LOA). For each accepted LOA, a unique case identifier number is assigned which identifies the country involved and the DOD branch (Army, Navy, etc.) providing the service.

The 1513 provides the general information concerning an FMS case such as the material requirements and the conditions and terms of the sale, however, more detailed information is required at the field implementation level. To satisfy this need, country program managers provide a case directive document which is used to implement the approved 1513. The case directive document includes the following.

a. Obligational authority control number, military department performing appropriations to be cited.

b. Delivery/shipping instructions: Issue priority, force activity designator, delivery term code, option code, freight forwarder code, mark for code, type of assistance code, media and status code, required availability dates, project codes, etc. [Ref. 8:p. 156]

The coded blocks of the DD 1513 along with the case directive provide the required information to develop the Military Standard Requisition and Issue Procedures (MILSTRIP) requisition. The MILSTRIP format is used to translate descriptions of specific requirements into a coded requisition document. The requisition once in MILSTRIP format can then be used in high-speed communications and automated data processing systems for use in the requisitioning and issuing of DOD material. [Ref. 11:p. 2-2]

Figure 4 is an example of the specific FMS codes used in the MILSTRIP requisition document. The card columns not addressed are completed similarly to U.S. requisitions.

The following indicates the MILSTRIP requisition card columns where specific modifications, as shown in Figure 4, are made for FMS transactions:

Column 30 contains the U.S. implementing agency code. Navy = P, Air Force = R, Army = D.

Columns 31 and 32 designate the purchasing country.

Column 34 contains the Delivery Term Code (DTC) which indicates the point in the transportation cycle where responsibility for physical movement of an FMS shipment passes from the U.S./DOD to the purchaser. The DTC is used by SAAC in determining the transportation charges to be assessed to the purchaser.

Column 35 contains the type assistance code which identifies the financial terms of the sale used to procure the material.

Column 45 designates the foreign government service which is to receive the material.

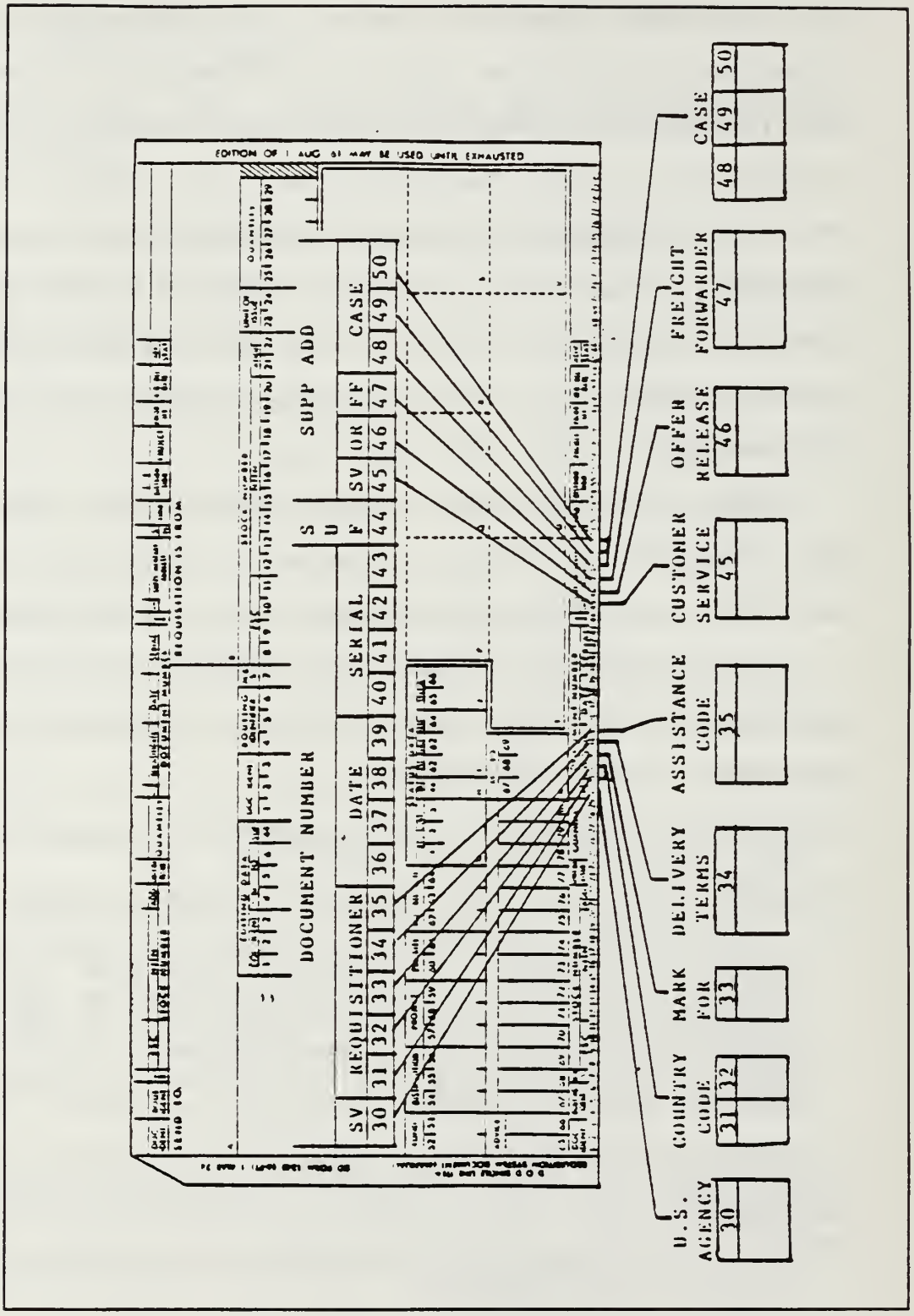

Figure 4 FMS Modifications to MILSTRIP Requisitions
Source: Navy Supply Corps School

Column 46 identifies the offer release code which specifies whether shipments are to be automatically released or whether the shipper must send out a Notice of Availability (NOA) advising that shipment is planned to occur.

Column 47 identifies the freight forwarder code which simply designates which freight forwarder will receive the shipment.

Columns 48-50 contain the 3 letter case designation code which is used to identify each requisition to a specific case.

FMS MILSTRIP requisitions are usually initiated by the customer country but can also originate from a designated U.S. military component.

D. FMS MATERIAL ISSUING AND SHIPPING PROCEDURES

NAVILCO has been designated as the Requisition Control Office (RCO) for Navy FMS requisitions. As RCO it receives and verifies all FMS requisitions prepared by foreign countries prior to introduction into the U.S. logistics system. Once requisitions have been received at NAVILCO, they will be entered into the Management Information System for International Logistics (MISIL) computer system. The MISIL is the automated system used by NAVILCO to verify and monitor the supply and financial performance of implemented cases and also to report case status to the purchasers and to SAAC. Once the requisitions are verified by NAVILCO, they will be routed to the appropriate Inventory Control Point (ICP). The Naval Supply System supports two ICPs, the Aviation Supply Office

(ASO) and the Ships Parts Control Center (SPCC). When FMS requisitions are received, the cognizant inventory manager at the ICP determines whether the material will be issued from available stocks or whether the ICP must buy the item. In the case of a stock issue, the ICP will forward a Material Release Order (MRO) to the applicable stock point with issuing instructions. The ICPs then generate a suspense file indicating material issue and adjust their inventory records. [Ref. 12]

When the requisition is received at the stock point, it is handled the same as any DOD requisition. The material is pulled from the shelf, packaged and marked for shipment, and the transaction is reported back to the ICP and NAVILCO. The MILSTRIP data on the requisition contains all of the required information to implement these actions. The arrangements for transportation of the material are agreed to in advance and are found on the DD 1513 in blocks 19, 20, 33, and 34. The shipping instructions for the material are repeated on the MILSTRIP requisition used by the stock points.

The initial point of shipment for FMS material is considered the point of origin. The point of delivery is the point where responsibility for physical movement of the FMS material passes from the U.S. Government to the foreign government. For most stock issues, the issuing depot's loading facility is both the point of origin and point of delivery.

Title to equipment and material will pass at the initial point of shipment (point of origin) unless otherwise specified in the DD 1513. For material supplied from DOD stock, title transfer will occur at the U.S. depot. Title to defense articles transported via parcel post passes to the purchaser on the date of parcel post shipment.

E. STOCK FUNDING THE SUPPLY SYSTEM

On October 1, 1991, one of the largest supply system infrastructure changes took place with the implementation of DMRD 901. Prior to this directive, the Navy Stock Fund was used solely for the procurement of retail and wholesale inventories of materials and spare parts. The costs associated with the supply operations at the Inventory Control Points (ICPs) and stock points were financed by the Operations and Maintenance appropriation. Under DMRD 901, DOD instituted financing of supply operations in the Stock Fund to provide for a total cost concept within the Supply System to help identify and reduce operating costs. In keeping with this total cost concept for supply support, the supply operations costs now financed through the Stock Fund will be recovered as a part of the cost of providing materials and included in the standard price of stock numbered items. [Ref. 13:p. 28]

F. DSAA TRANSPORTATION POLICIES PRIOR TO STOCK FUNDING

The current DSAA transportation pricing policy is tightly linked with FMS legislative requirements for cost recovery. Prior to stock funding the supply system, most countries were responsible for all aspects of transporting material purchased through FMS. These countries would make arrangements with freight forwarders who would pick up material from the stock points and be responsible for the transportation and delivery from the U.S. to the ultimate in-country destination. Under this scenario, a delivery term code (DTC) of 4 in column 34 of the MILSTRIP document was used to indicate that the FMS material was to be shipped from the stock point to the freight forwarder designated in column 47. A DTC of 4 also instructed the shipping activity to transport the material to the freight forwarder under a collect commercial bill of lading (CCBL) with the freight charges being paid by the freight forwarder.

On 1 October 1991, DMRD 901 stock funding initiative took effect and changed the way stock funded material was handled. Under this program the base price for stock funded material included the cost of transportation to the purchaser's freight forwarder and/or port of embarkation. This meant that the Defense Transportation System (DTS) was authorized for the movement of stock fund material to the purchaser's freight forwarder. The use of CCBLs for stock fund items stopped immediately. The applicable implementing agency (IA) stock

account pays transportation costs to the freight forwarder and the customer country is responsible for onward transportation.

For smaller shipments, weighing 100 pounds or less and 141 inches or less in combined length and girth, transportation officers are authorized to utilize either the U.S. Postal Service parcel post facilities or commercial package carrier equivalents such as United Parcel Service (UPS) or Federal Express Corporation (FEC). When shipment is via domestic parcel post or commercial carrier equivalent, the transportation service selected must provide a proof of entry into the transportation network and a proof of delivery to the consignee. [Ref. 8:p. 345]

Shipping activities properly mark and ship material by using the Military Assistance Program Address Codes (MAPAC) found on the requisition. Specifically, MILSTRIP requisition card columns 31, 32, 33, 45, 46, and 47 provide all the information necessary to construct a MAPAC. The MAPAC codes are listed in the Military Assistance Program Address Directory (MAPAD), DD 4000.25. The MAPAD contains the addresses required for shipment of material and distribution of related documentation for the FMS program.

G. USE OF THE DEFENSE TRANSPORTATION SYSTEM

Any exceptions to the basic FMS delivery policy in which the customer country is responsible for transportation services beyond the second destination must be noted on the

DD 1513 and approved by DSAA. Under such an exception the DTC would be other than a 4, which authorizes the use of transportation arranged and prepaid by the U.S. Government. The DTC also indicates how far the U.S. is responsible for payment of freight and handling charges.

Normally, firearms, explosives, lethal chemicals, other hazardous material and, occasionally, classified material are moved within the DTS on a Government Bill of Lading (GBL) to the CONUS port of exit. The onward movement of these items may be effected by purchaser-owned or controlled aircraft or purchaser-owned, operated or controlled surface vessels. FMS material which requires exceptional movement procedures, such as some sensitive and hazardous material will be shipped through CONUS water or aerial port facilities controlled by DOD. Air cargo that exceeds commercial capability can also be delivered through DTS. [Ref 8:p. 346]

The prime movers within the DTS are under the authority of the U.S. Transportation Command located at Scott AFB, Illinois. They are:

- U.S. Air Force's Air Mobility Command (AMC) [formerly Military Airlift Command (MAC)]-- manages the DOD air terminals and onward movement of cargo booked on military airlift.
- U.S. Army's Military Traffic Management Command (MTMC)--the single manager for military traffic, land transportation, and common-user ocean terminals within the U.S. and selected overseas locations.
- U.S. Navy's Military Sealift Command (MSC)--provides worldwide ocean transportation for DOD.

FMS material is transported within the DTS using the Military Standard Transportation and Movement Procedures (MILSTAMP). The purpose of MILSTAMP is to standardize and automate document flows. MILSTAMP uses the MILSTRIP requisition to create and exchange standard shipping data for recording and reporting shipment status, and controlling material movements in the DTS. [Ref 8:p. 314]

The shipment status and tracking for each FMS requisition is performed by the assignment of a transportation control number (TCN) derived from the document number found on the MILSTRIP requisition. When multiple FMS requisitions are consolidated into one shipment unit, a multipack, only one TCN is assigned to control the movement of the entire contents. The MILSTRIP requisition with the earliest required delivery date (RDD) is utilized to create the TCN which controls the shipment unit from origin to destination within the DTS. [Ref. 14:p. K-1]

There has been a problem in the past with consolidating FMS shipments into one multipack destined for a particular country. [Ref. 4] Because each country can have several active FMS cases for each of their services, (Army, Air Force, Navy) with a differing U.S. DOD sponsor, consolidation must be done judiciously. [Ref. 15] For example, several customer country Air Forces buy both U.S. Navy and U.S. Air Force aircraft. Just because a requisition is being shipped to

Saudi Arabia, it does not automatically mean that it can be consolidated with another Saudi shipment.

The packaging requirements for FMS shipments are determined by the "mark for" and "ship to" addresses in the MILSTRIP data as well as the type of material and the quantity to be shipped. Packages are marked as specified in the requisition and in accordance with standard marking and labeling procedures prescribed in MIL-STD-129.

The mode of shipment used for FMS material is determined by the priority of the requisition which is specified in blocks 60 and 61 of the MILSTRIP requisition. FMS requisitions use the Uniform Material Movement and Issue Priority System (UMIPS) which identifies the relative importance of competing demands for logistics systems resources. It establishes guidance for the ranking of material requirements and incremental time standards for material movement. This is done through the use of a two-digit code known as a priority designator. This designator is based on a combination of the mission designator assigned to the foreign country by the U.S. Joint Chiefs of Staff and the urgency of need for the material as designated by the requisitioning activity.

H. FMS PRICING BEFORE DMRD 901

Before stock funding took effect, price estimates of FMS material, afforded to foreign governments via the DD 1513,

consisted of a base price and appropriately allocated costs incurred by the U.S. Government relative to the performance specified by the DD 1513. These estimates provided for the recoupment of all DOD costs and an administrative surcharge for the use of the DOD logistics system.

For every foreign customer request for defense material, a Price and Availability (P&A) estimate is developed. In general, material offered for sale through an FMS case was to be priced following the same cost principles used in pricing defense articles for DOD use, with the addition of surcharges to ensure recovery of all costs. These surcharges were:

1. **Logistics Support Charge (LSC)**: Added to FMS requisitions for spare parts, supplies, and maintenance of customer owned equipment to recoup an appropriate share of the cost incurred in the logistics support area. The Logistics Support Charge was **3.1%** of the base price.

2. **Administration Charge**: Added to all FMS requisitions to recover expenses of sales negotiations, program control, computer programming, procurement, accounting, budgeting, and administration of FMS at command headquarters and higher levels. The assessment is **3%** of the base price.

3. **Accessorial Costs**: Represent expenses incident to issues and sales of material that are not included in the standard price. Accessorial Costs include:

a. Packing, Crating and Handling (PCH), to cover costs at DOD facilities for labor, materials, and services to take articles from storage, prepare them for shipment and

process the documentation. The PCH rate is **3.5%** of the selling price for materials with a unit price of under $50,000 and 1.0% of the unit price for over $50,000.

b. Transportation costs are the costs of DOD provided or financed transportation (land, air, inland and coastal waterways) in the U.S. and overseas transportation by vessel or air, including parcel post via surface or air. (The total transportation cost is dependent on how far the customer wants the USG to use the DTS for delivery. For most shipments, customers arrange and pay for the entire cost of transportation, from the point of origin to final destination, using freight forwarders.)

Table 1 portrays the standard format for computing total FMS estimated price for stock fund items.

TABLE 1. PRE-STOCK FUNDING COST RECOVERY FORMULA	
(Delivery Term Code 3)	
Material base price	$100.00
Packing Crating & Handling (3.5%)	$3.50
Transportation (Second Destination - 3.75%)	$3.75
Administration Charge (3.0%)	$3.00
Logistics Support Charge (3.1%)	$3.10
Total Estimated Cost	$113.35

Source: The Management of Security Assistance

I. FMS PRICING AFTER DMRD 901

Under the DMRD 901 stock funding initiative, the base price of stock funded material has an additional surcharge added to cover the price of all operations associated with the material issued. Stock fund surcharge rates are determined by Naval Supply Systems Command (NAVSUP) for Navy material. The Air Force Material

Command, the Army Materiel Command and the Defense Logistics Agency set surcharge rates respectively for material under their responsibility. The rates were determined by taking a percentage of the total operating costs associated with each ICP and Stock Point to cover those costs based on the value of annual demand. [Ref. 16] Each ICP has a different rate that applies to material that they control. Table 2 shows the stock fund surcharge rates for Navy and DLA material.

TABLE 2. STOCK FUND SURCHARGE RATES

NAVY	**FY-92**	**FY-93**
SPCC CONSUMABLES	26.7%	34.6%
ASO CONSUMABLES	39.2%	46.5%
SPCC REPAIRABLES	23.8%	33.4%
ASO REPAIRABLES	30.3%	32.2%
DLA		
DGSC (GENERAL)	36.6%	35.8%
DISC (INDUSTRIAL)	49.1%	41.1%
DCSC (CONSTRUCTION)	42.5%	38.4%
DESC (ELECTRICAL)	48.7%	34.7%

Source: Naval Supply Systems Command

The standard prices now encompass all operations costs including:

Transportation Costs: First and Second destination only.

Inventory Costs: Physical inventory losses, shipment losses, obsolescence,

Inventory Maintenance Costs: Working capital required to maintain approved inventory levels and make demand based changes.

Stock Point / Supply Operations: Recovers all costs of running supply system including receipt and issue functions at Supply Centers and operations at ICPs.

Because the standard price of material now covers all operating costs, the FMS surcharges that had previously been charged (LSE, Assessorial) have been deleted with the exception of the FMS administrative charge. Transportation charges still depend upon how far the customer wants the DTS to handle the material, with the exception of second destination charges.

Table 3 shows the new standard format for computing total FMS estimated price for stock fund items.

TABLE 3. STOCK FUNDING STANDARD PRICING EXAMPLE	
(Delivery Term Code 3)	
Established Replacement Cost	$100.00
Stock Fund Surcharge (34.6%)	$34.60
Subtotal	$134.60
FMS Administrative Surcharge (3.0%)	$4.04
Total Price	$138.64
Pre Stock Funding Total Price	$113.35
Total Difference	$25.29

Source: Naval Supply Systems Command, Security Assistance Div.

1. Price Comparison

The current pricing system reflects a 22% increase for material coming from SPCC. A price comparison of material from a DLA activity would show an even greater price differential. The increase in FMS prices is quite substantial and could continue to grow as projected increases for all surcharges is expected in FY-94. [Ref. 16]

The prices for FMS material are increasing significantly across the board in all categories of both Navy and DLA material. However, while standard material prices increased, the price for transportation services using the DTS decreased. The Delivery Term Code (DTC) found on the FMS requisition specifies a point of delivery for the material which indicates where responsibility for physical movement of an FMS shipment passes from the U.S./DOD to the purchasing nation. Figure 5 illustrates the DTS charges before and after stock funding.

A comparison of the DTS rates before and after stock funding shows that the pre-stock funding transportation charges were 3.75% higher in all categories of delivery. However, the reduction in transportation cost is more than made up by the 22% base price increase for material with the added surcharge.

The overall increase in prices has caused much concern to our FMS customers who now need substantial budget increases at home in order to maintain involvement in the FMS program.

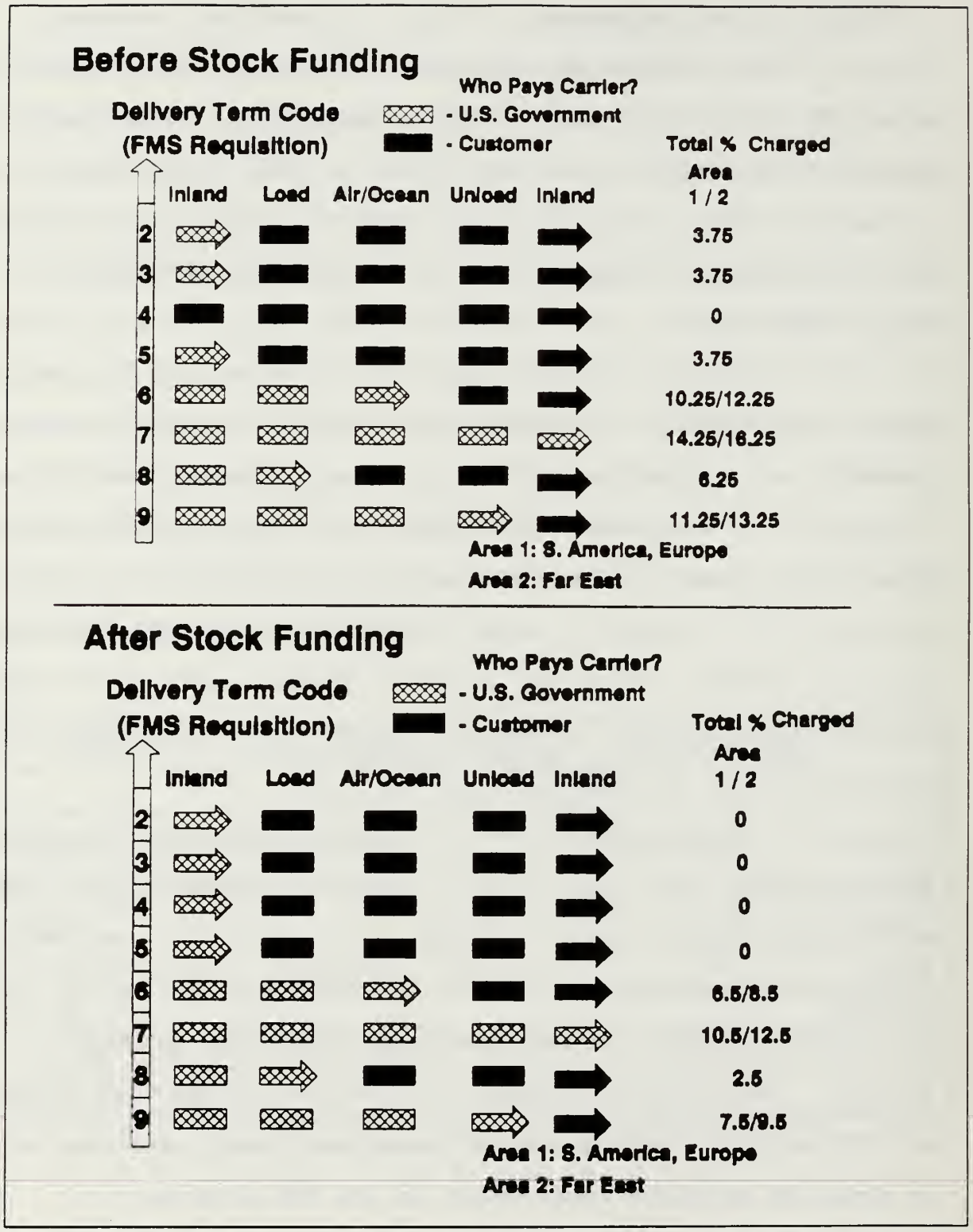

Figure 5 Shipment Rates Before and After Stock Funding
Source: Navy International Logistics Control Office

J. SUMMARY

This chapter has provided a background on the FMS program and has roughly shown how the transportation system has functioned both before and after the DMRD initiatives were implemented. In Chapter III, the DSAA transportation policies will be reviewed for their accuracy in assessing transportation charges to the FMS customers and whether this value of service type system meets the legal requirements under the Arms Export Control Act.

III. DSAA TRANSPORTATION POLICIES

A. INTRODUCTION

The Defense Security Assistance Agency (DSAA) transportation policy has been developed around the legislative requirement for cost recovery and more recently interwoven with the Defense Management Review (DMR) initiatives for reducing DOD supply system costs. This chapter will discuss the strengths and weaknesses of the value of service transportation pricing model used by DSAA and will include the DMR implementation issues that have recently changed the FMS program so dramatically. Additionally, actual transportation costs will be compared with the transportation charges assessed FMS customers to determine if the legislative requirement of "no profit or loss" is being met. The transportation cost look-up table will also be reviewed for its accuracy in assessing transportation charges to high cost items.

B. DSAA TRANSPORTATION POLICY - A VALUE OF SERVICE MODEL

The current DSAA transportation pricing method of assessing charges (Chapter II Figure 5) based on the how far the DTS was responsible for shipment, was developed over 20 years ago. According to Mr. Bob Florence at the Office of the Secretary of Defense Accounting Policy, these prices were

determined through "cost finding techniques". The rates were developed as an all-encompassing assessment, covering all of the costs associated with routing, carrier selection and administrative charges, to break even with no profit or loss resulting from the transportation of property. [Ref. 18]

When the DTS is used to transport FMS material, the Security Assistance Accounting Center (SAAC) uses the rates listed in Figure 5 Chapter II, when billing FMS customers, however, SAAC reimburses MSC, MTMC and AMC for their actual costs incurred in transporting the material. Figure 6 represents the flow of funds from the SAAC trust fund account and can be explained as follows.

-- Monies (in U.S. dollars) are received from the foreign customer in response to (1) the initial deposit requirement attendant to the acceptance of the DD Form 1513; (2) quarterly Billing Statements from SAAC. The monies are deposited into the FMS Trust Fund Account.

--Obligation authority (OA) is provided by the SAAC to the Implementing Agency (IA) at time of case implementation and receipt of deposit. Under reimbursable financing the IA cites its performing appropriation as the funding source and this appropriation is subsequently reimbursed by the SAAC following performance. Under direct citation financing, the IA cites the FMS Trust Fund Account on a DOD contract and no reimbursement is required. [Ref. 18:p. 2-14]

Unless the DD Form 1513 states otherwise, the FMS customer's cash deposits for defense articles and services sold under the AECA are made <u>in advance</u> of delivery, performance or progress payments to contractors. Foreign customer payments are forwarded by wire transfer or check to SAAC.

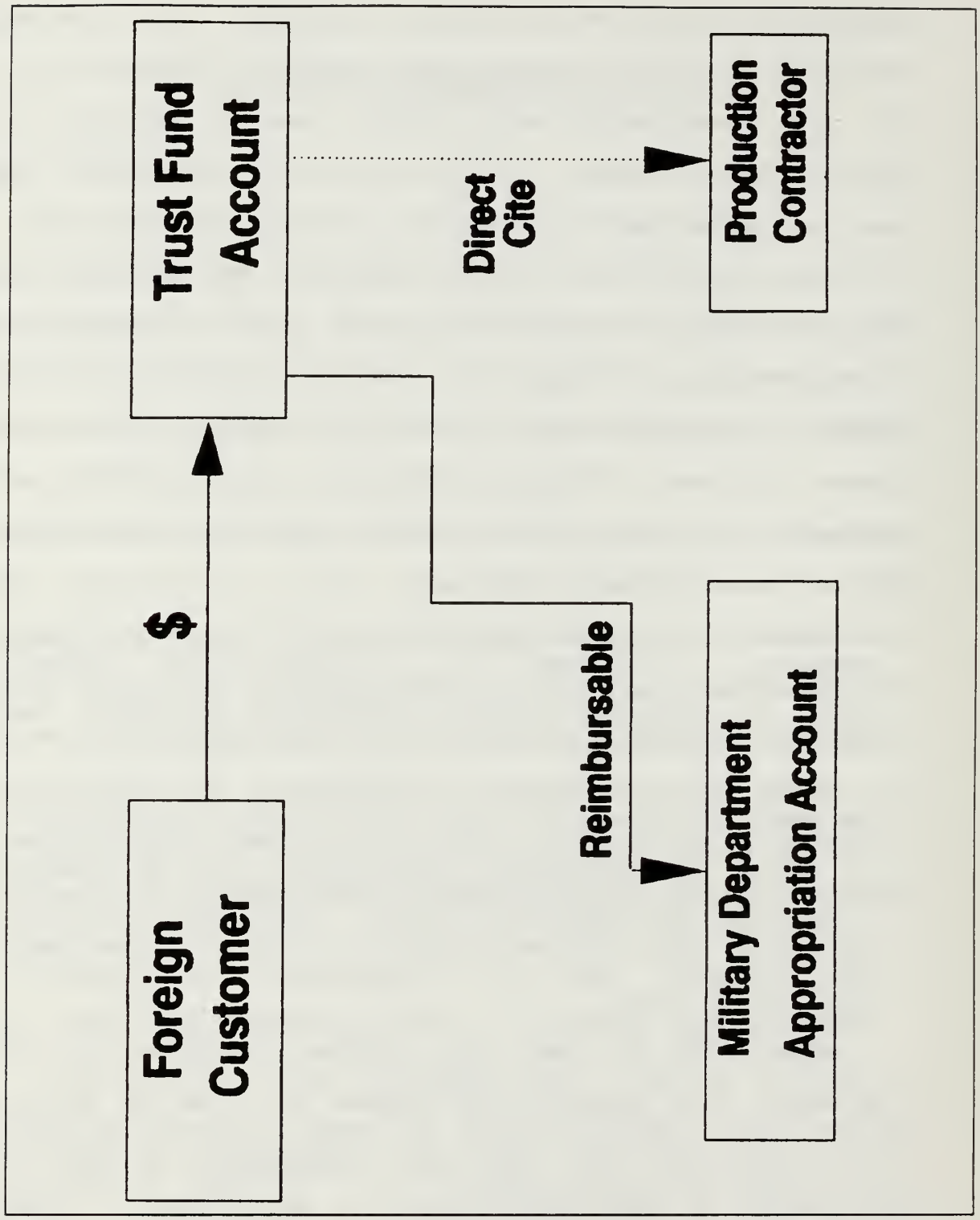

Figure 6 FMS Flow of Funds
Source: Management of Security Assistance

1. Value-Based Pricing

Value-based pricing implies setting prices based on what the customer is willing to pay. Rates for value-based pricing are set based on the perceived value of your service to customers relative to the options available. [REF. 19:p. 250] The common definition of value-of-service pricing in transportation is pricing according to the value of the product; for example, high-valued products are accorded high rates for their movement, and low-valued commodities are accorded low rates. [Ref. 19:p. 251]

Even though there is some criticism of this approach to rate-setting, it is a valid method. If transportation charges were looked at from a cost-based approach, high-valued commodities would usually be charged higher rates because they typically require special handling making them more expensive to transport. Additionally, the value of the material is a legitimate indicator of elasticity of demand. If a carrier has a complete monopoly, to consider value-of-service pricing only in terms of the value of the commodity would not lead to serious traffic losses. [Ref. 19:p. 252]

It would seem that the DSAA does have a monopoly over the movement of those military items which are required to move via the DTS, and therefore the use of value-of-service pricing would not result in traffic losses.

The value-based pricing strategy could result in recovering the cost of the service as required by the AECA. However, it is apparent that this method could also result in a loss on some low-value cargo movements or a profit on some high-value cargo movements. Figure 7 is a simplified example based on a surface movement of three commercial products: coal, televisions, and computers. In this instance, coal is a low-value item, televisions a moderate-value item, and computers a high-value item. Assuming all three products are moving by rail, and the rates charged result in the cost recovery depicted in Figure 7, then it is obvious that the rate charged for moving the coal does not cover the fully allocated costs; the rate charged for moving the televisions results in recovery of fully allocated costs, but no profit; and the rate charged for the movement of computers results in recovery of fully allocated costs, plus some profit. [Ref. 19:p. 252] However, fully allocated costs are somewhat arbitrary in that they may vary significantly between different allocation schemes and there is often no paramount rational for one scheme over all others.

C. ADVANTAGES OF THE DSAA TRANSPORTATION POLICY

One of the most prominent advantages of the current DSAA transportation pricing policy is that it allows the funds to be collected in advance. This ensures the FMS cases are closed in a timely manner, with no delay while waiting for the

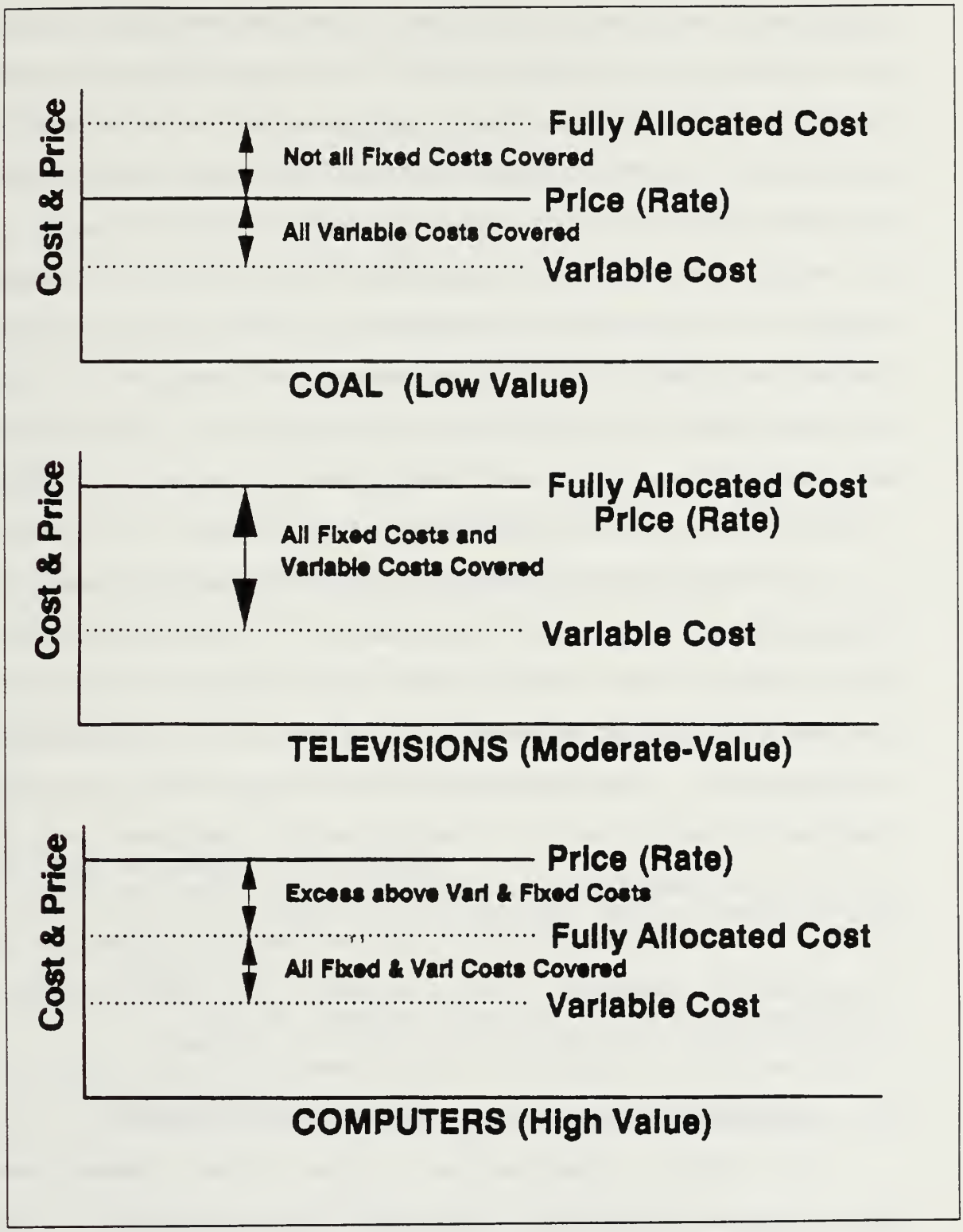

Figure 7 Cost Recovery for Value of Service Model
Source: Transportation

applicable DTS agency (e.g., AMC, MTMC, or MSC) to bill the FMS trust fund for the cost of the transportation service. Additionally, the transporting agencies are being reimbursed promptly for 100% of bills submitted without having to wait for FMS account reconciliation to confirm remittance.

Another advantage of the present method is that it is very simple. It does not require additional paper work or administrative efforts for FMS managers associated with transportation cost identification and measurement. Instead, the selling price of the item determines the price the foreign customer will pay for transportation services.

The current system also allows the FMS program to capture institutional charges not included in the DTS agency's bill. For example, AMC landing fees may inadvertently not be included in the AMC bill which is forwarded to the SAAC for reimbursement. In this case, the country will still be charged correctly as the transportation assessment has all applicable charges built into the rate. This way the U.S. does not take a loss due to billing errors on the part of the transporting agencies. FMS customers are also provided a complete audit trail for transportation charges.

D. DISADVANTAGES OF THE DSAA TRANSPORTATION POLICY

The obvious disadvantage of the current DSAA transportation pricing policy is the fact that cost recovery is not guaranteed and could result in either a profit or loss. For

large case customers who requisition a broad spectrum of different priced material this shouldn't be a problem. The transportation costs would even out as they would pay more for high priced items and less for lower cost ones. However, this pricing arrangement could work to the disadvantage of small case customers who purchase high priced items and may not have the amount of traffic to surmount transportation overcharges. This arrangement may also provide unfair discounts for small case countries who primarily purchase less expensive items. In either case, such a policy does not guarantee the cost recovery as dictated by the Arms Export Control Act.

Another disadvantage of the current system is that it is tied to the price of the material being shipped. If the price of the material rises or falls, then so will the transportation price, even though the cost of providing the service may or may not have changed correspondingly.

E. DMR IMPLEMENTATION ISSUES

1. U.S. Government Versus National Motor Freight Traffic Association

One of the biggest changes to FMS transportation procedures upon implementation of the DMR initiatives was the use of DTS for second destination transportation for FMS customers.

Historically, FMS second destination shipments have moved on collect commercial bills of lading (CCBL)s at the

applicable filed tariff rate at the expense of the foreign government. This practice was in line with the current DOD Financial Management Manual which states the use of "CCBLs should be used to the maximum extent possible." [Ref. 20:p. 70002.G] When GBLs were used, it was considered a reimbursable service for the purchaser and the transportation bill was annotated to show that normal commercial class rates and not guaranteed government rates should be billed for the shipment. [Ref. 21]

On 1 October, 1991, the DMR initiatives were implemented which abolished the policy of FMS stock funded material second destination movements on CCBLs. The second destination transportation was now the responsibility of the DTS and material would be transferred on GBLs.

Initially, the shipping activities were confused on exactly how to process the GBLs for FMS shipments. [Ref. 4] Because the title for the material transfers at the point of delivery, transporters did not know if they should arrange GBLs for FMS customers using the guaranteed government rates that they use for DOD material, or arrange the shipment using commercial class rates that are 50% - 70% higher. Questions on the specific procedures made their way up to the DSAA comptroller for a ruling.

In June 1992, the DSAA comptroller issued a memorandum stating that the guaranteed government rates do not apply to FMS shipments. [Ref. 22] The memo referenced research done by

the Defense Legal Services (DOD's lawyers) which found a previous U.S. Court of Claims case, Baggett Transportation Company v. United States in 1982. In this case, Baggett Transportation sued the USG to allow commercial class rates to be used for FMS shipments instead of the lower government tariff rate. The court ruled:

> The Arms Export Control Act requires the United States government to obtain reimbursement from the foreign government for administrative services, including transportation, performed primarily for the benefit of that foreign government in conjunction with FMS sales... Thus, it is the foreign government, not the United States government, that actually pays these charges and reaps the benefit of the lower prices. Consequently, the applicable filed tariff rates must properly be applied.
>
> The Arms Export Control Act puts defendant [United States] under an affirmative duty to collect reimbursement. If defendant does not do so, it should not be further allowed to shift the resulting financial burden, or part of it, to the carrier. [Ref. 23]

The ruling by DSAA in June 1992 appeared to clear up the questions concerning which rate to use. However, in July 1992, the DOD comptroller overruled DSAA and informed FMS activities that government rates for shipments of stock funded material to FMS customers do in fact apply for items being sold and shipped by DOD.

The National Motor Freight Traffic Association, Inc. (NMFTA) has since become involved, as the 50% - 60% difference between the commercial and government rates is quite substantial. Mr John Bagileo, representing the NMFTA, has stated that the NMFTA is not happy with the interim OSD decision to use government rates for FMS shipments and is

waiting for the OSD review of the decision to determine whether to file a lawsuit against the U.S. Government (USG) for commercial rates on FMS shipments since 1 October 1991. [Ref. 23]

2. Customer Service in Decline

On 1 October, 1991, the price for stock funded material increased between 23% - 39% (see Chapter II). Part of the increase was due to the USG assuming responsibility for the second destination transportation charges. However, the stock points that arrange the second destination transportation were not informed of the change until the end of November 1991, resulting in material still going out on CCBLs and resulting in double transportation charges for the FMS customers. There was still confusion as late as February 1992 as some stock points were delivering material on CCBLs. [Ref. 4] The double-charge problem continued to the point that several of our largest FMS customers, including Germany and Australia, started refusing to accept any CCBL at their freight forwarders. Unfortunately that decision meant that material arriving on a legitimate CCBL, such as material coming from a separate contractor, was refused too. When this happened, OSD intervened and arranged a special refund account to reimburse all double charged shipments. This solution requires a separate report of discrepancy for each individual over-charged shipment and requires the customer country to go

back and review every shipment since 1 Oct 1991 to determine if the material was stock funded or not. For our larger customers, this would include thousands of transactions over several months.

The problem of determining which items from the stock points are stock funded and which are not continues to be a problem. Stock funded items have an odd number in the cognizance (COG) code field of the requisition, non-stock funded items have an even numbered COG code. If a stock point has both stock funded and non-stock funded material to be delivered, it must be separated before delivery to ensure it is properly charged. This is causing problems at stock points that issue both kinds of material as warehousemen are not always looking at the COG code for material segregation and are loading available material for customers on the same truck and sending it all on GBLs. [Ref. 21]

From the FMS country point of view, the implementation of the DMR initiatives has not only cost them considerably more money, but the level of customer service has also declined. [Ref. 24]

3. Report of Discrepancy Processing

Each year the U.S. supply system handles a large number of FMS transactions. These transactions involve world-wide distribution of a great deal of material and, as with any large operation of this type, errors are sometimes made.

Therefore the FMS customer may not always receive the exact material ordered or have it delivered in the proper condition. When this happens, the mistake is called a discrepancy. There are four basic types of discrepancies:

- Shipment discrepancies,
- Packaging discrepancies,
- Billing discrepancies, and
- Financial discrepancies.

For the purpose of this study the author will review only shipment and packaging discrepancies that are the fault of the USG because these discrepancies sometimes require material to be shipped back to the U.S. utilizing the DTS.

The form used for reporting discrepancies is the Report of Discrepancy (ROD), Standard Form 364. This form is most often referred to by the short title "ROD." [Ref. 11:p. 7-1]

In the event that wrong, damaged, or too much/little material is shipped to an FMS customer requisitioning Navy material, they are required to forward a ROD to NAVILCO to receive a credit. NAVILCO will then advise the customer to provide NAVILCO with a copy of the shipping documents and return the discrepant material to the appropriate U.S. supply activity by using the DTS if available.

When the customer uses the DTS to return discrepant material, they will send NAVILCO proof that the material was

turned in to the DTS carrier. When the discrepant material is received by the appropriate U.S. supply activity, a credit will be generated by that activity and forwarded to NAVILCO. NAVILCO will then initiate a credit to the customers account at SAAC for all charges assessed against the original document number. The other DOD services follow similiar procedures.

When a material discrepancy as previously described happens, the U.S. is technically taking a loss on the transaction. Because the material may be origially shipped using the DTS and is returned using DTS, the USG is expending resources to move the material. The customer receives a credit for all charges, including transportation, for that transaction. Does transfer of discrepant material violate the "no profit - no loss" requirement of the AECA? Not really.

As previously stated, bills for the transportation of FMS material using the DTS, including RODs, are submitted by the DTS agencies to the SAAC FMS transportation trust fund. Because this fund is made up of money from FMS customers' transportation assessments and not from USG funds, the AECA is not being violated. This method of paying for ROD shipments has gone smoothly for years because the trust fund always had a surplus and could easily handle the additional charges stemming from ROD shipments. [Ref. 25] As previously mentioned, however, the trust fund has been losing money since the DMR initiatives were implemented. The question of who will pay for shipment errors caused by the stock points,

either the FMS transportation account or the appropriate stock fund account, is now under review by DSAA.

F. ACTUAL VERSUS COLLECTED TRANSPORTATION COSTS

To determine how accurate the transportation assessments to FMS customers are, in terms of being close to the actual cost, a random sample of 100 transactions were taken from the SAAC Transportation Subsystem Report of Shipments computer records. This report shows all disbursements made from the transportation trust fund to pay for the actual charges submitted by MTMC, AMC, and MSC. Each transaction is listed by the requisition document number. After choosing 100 transactions from this listing, the document numbers were searched in the FMS Detail Delivery History records. These records show in detail all of the charges that will be included on the quarterly billing statement to the FMS customer and includes the price charged for the material, assessorial charges, administrative charges, and transportation charges. Table 4 shows the results of this comparison.

Of the one-hundred samples summarized in Table 4, the current pricing system generated $29,747.98 in charges to FMS countries for transportation services, however, the actual charges to the transportation account were $57,520.34. The difference of $27,772.36 or approximately 48% was not charged to the FMS customer. At first look, the FMS customers appear

TABLE 4. ACTUAL VS BILLED TRANSPORTATION CHARGES	
Actual Charge to Transportation Account	$57,520.34
Total Charged to FMS Customer Countries	$29,747.98
Difference of Actual vs. Charged	$27,772.36
Transportation Provided but Document Coded to Reflect No Transportation Charge	$17,521.81
Transportation Provided but No Bill Processed	$14,595.86
When Billed Correctly - Actual vs. Charged (Customer Overcharged)	($4,345.31)

to be undercharged, however, with the revised transportation responsibilities under the DMRs, this may not be the case.

1. Reasons for the Shortage

Transportation charges assessed by SAAC are based on the Delivery Term Code (DTC) of the requisition and the Transportation Bill Code (TBC) assigned by the transportation offices. The TBC is a code used by the transporters to override the DTC. Because the DTC is decided upon when the case or DD 1513 is originally signed, any requisition for material using that case will have the same DTC regardless of how the material is actually shipped. The TBC allows transporters to override the DTC when a method of shipment is different from the original DTC. For example, if a requisition with a DTC of 4, which means the FMS country is responsible for all transportation, is shipped using the Defense Transportation Service (DTS), the transporters will

assign an appropriate TBC which will tell SAAC to charge the country for transportation services.

Of the one-hundred sampled transactions, forty-five were coded with a DTC of 4 and/or a TBC of "D" or left blank which means that the FMS country is responsible for transporting the material and no transportation charges are to be assessed. However, as shown in Table 4, $17,521.81 was billed to the transportation trust fund account for these requisitions. One reason for this could be that transporters were billing the FMS account for second destination services that should have been billed to the stock fund when the DMRs were implemented. As previously mentioned, the new procedures required by the DMRs took several months to implement which could account for some of the charges.

In twenty-two of the samples, no bill for that document number had been processed by SAAC, therefore no transportation charges had been assessed. As shown in Table 4, these transactions accounted for $14,595.86. These transactions could still be processed and properly charged, however, most of these were over one year old.

A comparison of the actual transportation charges for correctly processed billing documents shows that the amount charged the customer exceeded the actual cost by $4,345.31 for the thirty-three transactions ($34,093.29 less $29,747.98).

Although the total sample size was small and the randomly selected transactions could be exceptions rather than

the norm, the results do indicate some problems. Before the DMR initiatives were implemented, the transportation trust fund had a surplus of over $100 million dollars. Since 1 October 1991, the surplus has decreased by over $92 million dollars. [Ref. 25] This would concur with the sample results that showed a significant amount more being charged to the trust fund than what was being replaced with receipts from customer bills. This point will be further discussed in Chapter V.

G. TRANSPORTATION COST LOOK-UP TABLE

Transportation charges for using the DTS are usually determined by assessing a straight surcharge for the distance that the DTS was used, however, for certain high cost items the surcharges are not assessed. Instead the transportation cost look-up table is used. An example of the table is shown in Figure 8. The purpose of the table is to provide an estimated actual transportation charge for high cost items that are always shipped using the DTS such as missile systems and components. The look-up table was developed for items whose transportation charge using standard transportation percentages differed significantly from the actual transportation cost.

In theory the idea behind the look-up table is sound. Under a value of service pricing model, a high cost item will bring in more transportation revenue than a comparable size

NAVY ANNEX

NSN	ITEM	Code 6*	Code 8*	Code 9*
HARM MISSILE				
1410-01-168-8663	Tactical Missile	$3,900	$3,302	$8,169
1410-01-166-9263	Training Missile	3,900	3,324	8,169
1420-01-162-3292	Guidance Section	3,439	3,179	3,727
1420-01-161-2090	Control Section	3,439	3,179	4,304
1337-01-162-3422	Warhead Section	3,439	3,179	2,782
1337-01-162-3421	Rocket Motor Section	3,439	3,179	4,661
HARPOON MISSILE				
1410-01-181-8546	AGM-84D-1	$3,859	$3,291	$7,458
1410-01-181-8548	AGM-84D-2	4,147	3,368	9,678
1410-01-139-1741	RGM-84D-3	5,486	3,720	10,034
1410-01-198-7063	RGM-84D-4	5,486	3,720	10,330
1410-01-181-8549	UGM-84D-1	5,143	3,462	10,062

AIR FORCE ANNEX

NSN	ITEM	Code 6*	Code 8*	Code 9*
MAVERICK				
1410-01-101-8490JE	AGM-65A	$4,381	$3,918	$6,251
1410-01-089-2505JE	AGM-65B	4,381	3,918	6,251
1410-00-125-6760JE	AGM-65B	4,381	3,918	6,251
1410-00-238-1486JE	AGM-65A	4,381	3,918	6,251
1336-00-138-2910JE	AGM-65B	4,381	3,918	6,251
1336-00-883-5361	Warhead	1,373	1,328	1,806
1336-00-883-2682	Booster Warhead	1,321	1,317	1,333
1337-01-118-4657	Rocket Motor	1,406	1,334	1,860
SIDEWINDER				
1410-01-135-2771AB	AIM-9L	$232	$161	$1,366
1410-01-137-5971AB	AIM-9E-2	232	161	1,366
1410-01-137-5972AB	AIM-9P-3	232	161	1,366
1410-01-162-9395AB	AIM-9M	232	161	1,366
SPARROW				
1410-01-101-8237BL	AIM-7E-3	$424	$292	$2,802
1410-01-135-6167BL	AIM-7E	424	292	2,802

Figure 8 FMS Cost Look-Up Table
Source: Security Assistance Management Manual

and weight low cost item. This is particularly true for the high technology missile systems available to our FMS customers that have a significant base price. For example if South Korea were to purchase 10 (RGM-84D) HARPOON missiles for in-country delivery, the cost using standard surcharges is shown in Table 5. Using the look-up table, the transportation charge is shown in Table 6.

TABLE 5. STANDARD TRANSPORTATION ASSESSMENT	
Base Price - $400,000.00 x 10	$4,000,000.00
Transportation Assessment (DTC - 9)	9.5%
Total Transportation Charge	$380,000.00

TABLE 6. LOOK-UP TABLE TRANSPORTATION RATES	
Look-up table rate for 1 unit	$10,034.00
Number of Missiles	10
Total Transportation Charge	$100,340.00
Difference Between Std & Look-up rates	$279,660.00

1. Problems Using the Look-Up Table

Although using the look-up table does reduce the trans-portation charges for these high cost items, the table in no way reflects the actual transportation cost. [Ref. 26] The look-up table is supposed to reflect the transportation cost of material from the source of supply to the in-country destination. For example, the shipment of AGM 65 missiles to

Korea, used in the previous illustration, includes transportation from the missile manufacturer, Hughes Aircraft in Arizona, to the designated in-country destination. The problem lies in the fact that the USG would assess the same transportation charge to Mexico if they bought those same missiles and had them shipped on a DTS truck across the border. Obviously, the cost to air ship material half-way around the world would be more than a 300 mile truck haul. Using the look-up table, the transportation charge is the same no matter which country in the world the DTS is sending it to.

Another problem with the look-up table is that the quantity of material shipped does not change the percentage charged. This doesn't take into account standard quantity discounts such as truckload rates, that are considerably lower than less-than-truckload rates. For the most part, the items listed in the look-up table are missiles. When FMS countries decide to purchase missiles from the U.S., the quantities are almost always for more than just one. [Ref. 26] However, the look-up table gives the price to transport one of each item and additional quantities are multiplied by the single quantity unit price.

An example of the look-up table's peculiar rate assessment happened recently when Spain arranged to purchase

175 (AGM 65) missiles[1] from the Air Force. Table 7 shows the look-up table transportation charge.

TABLE 7. LOOK-UP TABLE RATE FOR AGM-65 MISSILES	
Look-up Table Rate for AGM-65	$6,500.00
Quantity Purchased	175
Total Price	$1,093,925.00

Spain asked the Air Force what the actual charge for shipping that quantity of material would be. The Air Force determined that the actual transportation charge would be approximately $ 177,000.00, a difference of $ 916,925.00. Spain made a special arrangement on their DD 1513 to have the missiles shipped at actual cost instead of using the look-up table rate. [Ref. 26]

2. How Look-Up Rates are Determined

The look-up table rates are difficult to determine because the Military Departments (MILDEPS) must come up with one rate that will recoup the transportation cost for delivery anywhere in the world. Adding to the difficulty is the fact that the transportation cost originates from the CONUS point of origin. In the case of some of the look-up table items, there are multiple manufacturing points for the same item. For example, in the Spanish (AGM 65) purchase of 175 missiles,

[1]Number changed for example purposes due to sensitivity of actual information.

100 could have come from the Hughes plant in Arizona, 25 from California and the balance from a third manufacturing point in the U.S. It is difficult for the MILDEPs to come up with one all-encompassing rate that would realistically cover multiple origins to multiple destinations in the world. [Ref. 26] To determine a look-up table rate, the Navy and the Air Force take the 10 most frequent FMS customers of the particular item, determine what the average cost would be to ship the item to that country, and determine a total average cost from all of the countries for the look-up table. [Ref. 26]

H. SUMMARY

This chapter has reviewed the current DSAA transportation pricing policy and the problems of implementing the DMR initiatives. It compared the prices charged FMS customers against the actual transportation costs, reviewed the look-up table method of pricing high cost items, and discussed the customer service aspects of the current policies. Chapter IV will assess how a different pricing model might work for the FMS program and the advantages and disadvantages such a model would present.

CHAPTER IV. AN ALTERNATE TRANSPORTATION PRICING STRATEGY

A. INTRODUCTION

The purpose of this chapter is to review an alternate transportation pricing strategy for the FMS program. In Chapter III, the current Defense Security Assistance Agency (DSAA) policy based on a value of service model was analyzed. This chapter will discuss the attributes of a cost-based strategy, which is currently favored by OSD, to determine the relevance to the DSAA transportation pricing policy.

B. COST-BASED PRICING

Cost-based pricing is determined by identifying the costs incurred for providing a service or product, plus some predetermined margin of return.[Ref. 27:p. 14] In a non-profit organization for which the goal is to recover costs only, the margin of return is zero.

1. Attributes of Cost-Based Pricing

Cost-based pricing establishes the lower limit below which prices should not be set. [Ref. 27:p. 15] One problem with this system is that there is frequently an inadequacy of cost measurement and cost definition. Objective cost data is essential for deciding what price to set. When considering the cost aspect of a pricing decision, the crucial question is what costs are relevant to the decision.[Ref. 27:p. 16]

2. Relevant Costs

Temple, Barker, and Sloane, Inc, identify several costing elements which are relevant to cost-based pricing decisions. These elements, as well as additional costs that the author determined relevant, are listed below.

a. Natural costs (factor costs) -- refer to the component costs of producing a service or product (e.g., labor, fuel, equipment, parts, supplies, and rent)

b. Functional costs -- costs of performing a particular element of the service (e.g., the cost of transporting FMS material from the source of supply to the CONUS port).

c. Direct and Indirect costs -- Direct costs can be traced directly to the performance of a specific shipment or customer. Indirect costs are not associated with a particular unit because they cannot be specifically assigned (e.g., utilities costs in a warehouse).

d. Variable and Fixed costs -- Variable costs change with some measure of volume or activity over a specific period of time with volume or activity levels. Fixed costs do not change with volume or activity levels over a specified period of time.

e. Fully allocated and Incremental costs -- Fully allocated costs are the sum of all variable and fixed costs that have been assigned to a specific shipment. Incremental costs are the costs associated with producing one more unit

f. Standard and Replacement costs -- Standard costs reflect reasonable expectations of performance in productivity levels, compliance, capacity utilization, and factor costs. Replacement costs include equipment and facilities replacement costs based on inflationary conditions. [Ref. 27:p. 19-24]

Cost-based pricing is often called satisficing or target-based pricing.[Ref. 28:p. 315] This strategy requires a carrier to set his price at a level that will produce a satisfactory financial return. A cost-based strategy can be

useful in certain circumstances, e.g., long-term contracts, but is frequently criticized because it forgoes opportunities to price at even higher rates. [Ref. 28:p. 316]

Since cost-based pricing focuses on recovery of costs, plus some predetermined margin of return, this method may be applied to the DSAA transportation pricing strategy as it would meet the requirement for cost recovery as required by the Arms Export Control Act. Additionally, MTMC, AMC and MSC are currently billing the SAAC trust fund for the actual costs of transportation services provided to FMS customers indicating that at least partial cost identification is plausible and possible in this situation.

C. ADVANTAGES OF A COST-BASED PRICING SYSTEM

One of the major advantages of the cost-based system is that recoupment of transportation costs would no longer be tied to delivery reporting from the stock points. Currently, all charges for material and assessments for transportation are not processed until SAAC receives notification from the Implementing Agency (IA)" that the transaction has occurred. This situation was highlighted in the sample of transactions analyzed in Chapter III, where 21 of the 100 requisitions sampled had been billed by the DTS for transportation but had not been charged to the country by SAAC due to non-receipt of the transaction delivery report from the IA.

Another advantage to actual costing is that changes to delivery conditions could be made after the initial shipment without the transporters having to go back and change the delivery report sent to SAAC. Currently, the method and mode of delivery for FMS shipments is determined when material is issued at the stock point. After the issue is made, the delivery performance report is sent from the stock point to SAAC which, among other things, indicates how much to charge for transportation. If the material later gets rerouted to another mode of shipment, transporters must send a modification to the original delivery report to SAAC. According to Ray Bilo of NAVILCO, modifications to delivery reports are currently seldom made by transporters resulting in inaccurate transportation charges. [Ref. 4] Under a cost-based system, modifications would not be required as the transportation charge would reflect how the material was actually shipped.

D. DISADVANTAGES OF A COST-BASED SYSTEM

1. Integration With DTS Material Consolidation Methods

One of the major drawbacks of using an actual costing or cost-based system would be integrating it into the current DTS method of consolidating shipments. FMS shipments are often consolidated at the stock point packing facility or at the air or water freight staging areas at AMC and MSC. These shipments, include several items ordered on separate

requisitions and are shipped to the customer in a single container. The external markings on the container and the bill of lading (manifest, waybill, etc.) will often show only one of the many requisition numbers applicable to the material contained inside. This number, the "lead document number" or transportation control number (TCN), is used by DTS to submit bills to SAAC for transportation services. [Ref. 11:p. 7-15] For example, the transportation charges for a consolidated shipping container with one hundred requisitions packed inside would be applied to the lead document number only. The other requisitions packed inside would not be charged for transportation nor could they be traced to the lead document number for reference in the current financial billing system. This could cause confusion for our FMS customers in relating transportation charges to specific material deliveries.

2. Cost-Based System Increases Paperwork

Another problem with a cost-based system is the additional tracking required for non-stock funded items. As mentioned in Chapter III, the DMRD initiatives now require the USG to pay for the second destination charge for stock funded material, however, the second destination charge for non-stock funded material is still the responsibility of the FMS customer. Under the current system, if a non-stock funded item is issued from a stock point and is sent to the freight forwarder by parcel post or Federal Express, the FMS country

is assessed the standard 3.75% transportation charge. The issuing activity pays the actual cost for the transportation and at the end of the month, submits one bill to SAAC for reimbursement for the total of the non-stock funded items. Individual detailed records of charges for each document number are neither required nor currently kept.

If a cost-based system were used, the stock points would have to track each individual non-stock funded material transaction so that a detailed bill listing the corresponding transportation charges would be available. This would not only increase the administrative burden on transporters but would increase the number of transactions billed to SAAC. [Ref. 4]

3. FMS Case Closure Would be Slowed

A cost-based system could also slow the process of case closure. An FMS case is considered closed when all of the material requested on the DD-1513 has been delivered and all of the payments for that material have been received. Before a case is declared officially closed by SAAC, a final review is performed by the Implementing Agency (IA) to ensure that all deliveries of material and financial transactions have been completed. Under the current system, transportation charge problems rarely delay case closure as these charges are based on the value of the material. A detailed review of these charges by the IAs is unnecessary.

Under a cost-based system, the IAs would have to audit DTS bills in addition to the delivery/payment records they now review. If for some reason a transportation bill had not been submitted from one of the DTS links used to transport material for the case in review, then the case could not be closed until the bill had been submitted by the DTS and properly paid. The administrative burden of following up every transaction for appropriate transportation charges could be considerable using a cost-based system.

4. Processing Reports of Discrepancy

The process of FMS countries requesting replacements for damaged or discrepant material under a Report of Discrepancy (ROD) could become more difficult under a cost-based program. As mentioned in Chapter III, prior to the DMRD initiatives, the current system operated at a surplus which provided funds to process discrepant shipments for our FMS customers without assessing them additional transportation charges. Given that there should be no surplus on each sale, using a cost-based system would force countries to pay individually for ROD transportation services which would not be popular from a customer service aspect.

E. SUMMARY

This chapter has reviewed a cost-based approach to the DSAA transportation pricing policy. Although this approach is valid in satisfying the legislative requirements of the FMS

program, the additional paperwork, tracking of material and increased case closure time could cause problems if it was implemented. Chapter V will present conclusions and recommend a plan of action for the FMS program.

V. CONCLUSIONS AND RECOMMENDATIONS

A. OVERVIEW

This chapter will present the conclusions and recommend a plan of action for the FMS program based on the findings described in the previous chapters.

B. CONCLUSIONS

In an attempt to streamline the supply system and save money in a reduced budget environment, the DOD implemented the DMRD initiatives. In their zeal to make the overall system uniform, DOD forced the FMS program to adapt to the required cost cutting initiatives and treated it as an insignificant part of that system. Unfortunately for the FMS customer, the new DMRD regulations have meant higher prices for material and a reduction in customer service in the transportation of material. DOD's implementation process has resulted in a departure from the requirements of the Arms Export Control Act (AECA). For example, OSD decided to continue using the guaranteed government rates for FMS shipments when previous State and Federal Court rulings found this is in violation of the AECA. In all likelihood, the National Motor Freight Truckers Association will sue the USG and require FMS material to move using commercial tariffs. Subsequently, FMS material movements will cost the stock fund more money to process than

similar DOD movements. Because both DOD and FMS customers pay the same price for material, the stock fund and DOD customers would be partially subsidizing the FMS program which is a violation of the AECA.

DOD's vision of all DOD and FMS supply transactions being treated exactly the same, costing the same price, and using the same carriers for transportation, has reduced the level of customer service for FMS customers. The DMRD initiatives are also putting the FMS transportation trust fund into a deficit position.

1. Why is the System Losing Money?

Prior to the implementation of the DMRD initiatives, the DSAA transportation policies resulted in surpluses for the FMS transportation account. One aspect that probably contributed significantly to the surplus was the pre-DMRD 3.75% second destination charge assessed FMS customers who used the DTS. Of all of the individual transportation segments (second destination, air, water, etc.) the second destination charge to the SAAC transportation account was probably overlooked by military transporters more often than any other. At some of DOD's largest stock points, such as the Naval Supply Center in Norfolk, VA, the AMC terminal is within walking distance of the warehouse where material is issued. The second destination movement from the warehouse to the air terminal is done by military pallet truck or fork lift. In

this situation, no bill for the second destination service is sent to the SAAC trust fund, however, the FMS customer still paid the standard 3.75%, resulting in a surplus for the trust fund.[Ref. 4]

Another indicator that this 3.75% charge may have contributed to a surplus in the transportation trust fund is found by comparing it to the percentage now included in the stock fund surcharge for transportation. The transportation portion of the stock fund surcharge in FY-93 is 2.79%. Considering that the 1993 rate of 2.79%, based on actual costs, is almost one full percentage point below the 3.75% DSAA had been charging FMS customers since 1978, it is no wonder that the trust fund previously had a surplus.

This situation changed when the DMRD initiatives were implemented. Not only were FMS customers no longer paying the transportation trust fund a healthy 3.75% for second destination charges, but as mentioned in Chapter III, many Implementing Agencies (IAs) were incorrectly charging the FMS trust fund for transportation services that should have been paid for by the appropriate stock fund. These two situations have contributed to the recent decrease of $92 million in the FMS transportation trust fund.[Ref. 25]

2. The Current Policy is Flawed

The current system under the DMRD initiatives has increased the cost to the FMS customer and reduced the level

of customer service. FMS countries can no longer control the second destination transportation move which means they can't arrange or consolidate shipments with their freight forwarders. The current system requires countries to determine if the material they are buying is stock funded or not stock funded, even though DOD hasn't trained their own transporters to make that determination. The current system uses a transportation cost look-up table that bears no resemblance to actual transportation costs.

If the U.S. is serious about maintaining a strong FMS program, several changes must take place.

C. RECOMMENDATIONS

1. Change Second Destination Transportation Responsibility

The second destination transportation responsibility should be returned to the FMS customer. This, in itself, would solve several problems DSAA is now facing.

The legal problems with the NMFTA would disappear. Most FMS freight would once again be shipped on CCBLs after the carrier companies and the FMS customers have negotiated the rates. Customer service would also improve as FMS customers would again be able to choose the carrier and level of service required to best suit their needs.

FMS customers and DOD transporters would no longer have to sort material by cognizant codes to determine if it

was stock funded or not. All material would be handled the same regardless of which account funded the original purchase.

The only drawback to this change would be that if FMS material is shipped on a CCBL, the current stock fund surcharge would have to be reduced to "back out" the second destination charge. OSD's objection to this is that it would make a two tiered pricing system within DOD, and FMS customers would not be able to use DOD catalogs to determine the price of material.[Ref. 17] This argument isn't valid, however, as FMS customers have historically had to add assessorial percentages to the listed price of U.S. equipment. Looking up a price and deducting 2.5% to 3.0% for second destination charges would not be that difficult.

2. Discard the Transportation Look-Up Table

The transportation cost look-up table used for high value items should be discarded in favor of using the actual charge from the transporting agency. The look-up table does not come close to realistically assessing the cost of transportation and our customer countries are figuring that out. Making this change would not be difficult for SAAC to implement either. The transportation accounting system currently reviews transaction stock numbers before looking at Delivery Term Codes (DTCs) and Transportation Bill Codes (TBCs) to determine transportation charges. If the stock number on the transaction is listed on the look-up table, then

the actual charge from the MILDEP would be used instead of the rate listed in the table. Making this change would preclude the significant overcharging possible using the look-up table.

3. Periodically Review Transportation Charges

In order to find problem areas in the transportation trust fund, a periodic review of charges assessed the fund by MILDEPS should be compared with the country case delivery history records. Currently there is no audit of any charges assessed the FMS transportation trust fund. [Ref. 25] If a review similar to the one performed in this study was done periodically, SAAC could easily identify problem areas such as activities mistakenly charging the account or missing charges to the transportation activities. This review would help prevent the large surpluses and recent deficits that have plagued the transportation trust fund.

4. Maintain the Value of Service Pricing Model

The value of service pricing model currently used by DSAA should be continued. This system has worked in the past and has fewer overall disadvantages than a cost-based system. The problem of excessive surpluses in the trust fund account should be reduced by abolishing the cost look-up table. If not, the transportation assessment percentages should be adjusted to maintain only a small surplus to handle contingencies such as customer Reports of Discrepancies (RODs).

The changes listed above have been recommended by the author to improve the customer service to the FMS customers. A surplus position in the trust fund enables DOD to handle RODs through the FMS program without directly charging the customer for the mistake. RODs should be considered a cost of doing business and as such must be paid by the FMS program. The current method of giving the FMS customer full credit for the valid ROD and charging the trust fund for the transportation services makes sense from a customer service point of view, however, a positive balance in the trust fund is needed to make this happen. The positive balance should not be considered a violation of the AECA as the funds would be used to offset potential losses to the USG which would also be a violation.

D. FINAL COMMENTS

The DMRD initiatives have resulted in considerable changes to the FMS program. There will almost certainly continue to be more changes as a new administration looks for even deeper cuts in the DOD budget. The theme this author heard repeatedly from all of the people interviewed for this study was that the system is changing fast and exactly where it is headed is not certain. Unfortunately the changes to our defense supply system are being made without much attention paid to the security assistance programs, forcing reactive policies to be implemented to make FMS fit in with the new

system. The DOD decision makers must remember that there is a fundamental difference between DOD and FMS customers.

Customers within the DOD system have no choice on the issue of where they will take their business for defense related material and should be expected to accept belt tightening measures to reduce costs in the post cold war budget environment. The FMS customer, on the other hand, can take their business elsewhere, as the U.S. is not the only manufacturer of defense equipment. The FMS program is in competition with other international companies. The U.S. performance in Desert Storm showed the world that the best-made military equipment comes from the U.S. That advantage should not be squandered on decisions made by DOD that ignore the FMS program. [Ref. 29]

From an economic point of view, FMS helps the U.S. balance of trade. It is an additional source of capital for our defense industrial base which has been hurt by recent cutbacks due to the changing priorities of the U.S. budget. In fact, some major defense industries, such as tank manufacturing, are being kept alive only because of sales made through the FMS program. [Ref. 29]

In order to continue with the tradition of security assistance and enjoy the benefits that such a program provides, we must tailor current initiatives to include our FMS customers or run the risk of having them take their business elsewhere. As President Reagan once stated, "Dollar

for dollar, security assistance contributes as much to global security as our own defense budget." [Ref. 8:p. 23] In today's world where regional conflicts are more likely than global ones, the U.S. security assistance programs are necessary if we want to continue our leadership role in the free world.

Country	Document Number	Actual Transportation Charge	Amount Billed To Customer	Delivery Term & Type Assist Codes
BC	8108A315	13.85	1165.37	9M
	0351E702	30.91	0.00	9M
BE	02496077	4.67	9.69	44
	02496052	63.55	3.45	44
	02496064	2.38	0.00	44
	00626092	69.77	127.02	44
	02496004	73.99	1.13	44
	12776657	4.67	0	44
BH	73239011	264.88	1185.3	9N
	21057655	18.71		9Z
	21057649	18.71		9Z
	21057653	18.71		9Z
	62305001	3435.75	0	64
BL	82510677	136		6Z
	822454KN	63.16		6Z
	822370KN	1747.5		6Z
	822369KN	1747.5		6Z
	822332KN	357.93		6Z
BR	00957600	2076.5	0	4V
	12846006	342.89	1524.4	44
	12498109	16.55		44
	12497826	1	0	44
	12499729	226.64	156.3	44
	12527389	45.33		44
	92588585	232.57	467.85	24
	92588010	58.14	141.05	24
	92588176	58.14	120.47	24
	92589319	58.14	123.41	24
	50060701	1664.4		45
	11490005	6933	4465	44
	82386003	7.62	40.47	85
CD	82490021	7996.56	7880.54	9M
	2030E711	592	340.1	9N
	2030E720	4708.56	2204	9N
CM	8075A145	93	78.4	94
	01801016	184.88		94

CN	10092184	1		4V
	13532262	2.93	0	4V
	13532263	2.93	0	4V
	13532264	2.93	0	4V
	13532265	2.93	0	4V
	60185016	118.24	0	44
	71386024	35.73	0	44
	11586397	1.97	0	44
	11586027	28.33	0	44
	11586976	3.67	0	44
	8133G332	2053.52	0	44
	93340387	415.3	5159.12	44
	11782200	689.65	0	44
	12672066	28.33	780	44
	10922038	243.64	0	44
	12682161	56.66	0	44
	11702016	375.04	0	44
	21611659	282.27	0	44
	82580045	58.14	55.98	4V
	82770181	0	0	4V
	83470071	58.14	0	4V
	83270166	107.1	0	4V
	11132143	74.27	0	4V
	11122263	7.44	0	4V
	73280484	56.66	425.63	4V
	11652039	28.33	84	4V
	11152193	0	0	4V
	00741151	174.43	167.4	4V
	00603539	58.14	1.7	4V
	92070326	58.14	70.13	4V
	92070327	116.38	140.26	4V
	00732093	58.14	40.13	4V
	03472145	74.27	66.45	4V
	02001371	141.65	0	4V
	03402026	3.67	0	4V
	00932477	71.46	0	4V
	03442487	45.46	0	4V
	03652081	6842.53	0	4V
	90468003	1.45	0	44
	20062431	4.87	0	4V
	12272129	2.67	0	4V
	12332116	2.67	0	4V
	13032023	2.67	0	4V
	20632082	2.67	0	4V
	20632083	2.67	0	4V
	20642086	2.67	0	4V
	20642097	3.45	0	4V
	20642099	2.67	0	4V
	20682129	2.67	0	4V
	20632082	2.67	0	4V

CO	1079D007	657.63	0	53
	1079D008	25.36	0	53
	1079D025	1.65	0	53
	11489001	4128.5		8M
	10999005	165	180.35	8M
	10999001	2313.44	2542.88	8M
	02857624	10.99		0C
	02857635	49.95		0C
	02857639	3.66		0C
	03027602	4364.8		0C
	03027667	1.1		0C
	03017860	10.68		0C
	03017886	1.15		0C
	03017924	4.65		0C

Note: A "Blank" in Amount Billed to Customer Means No Delivery Report on Record at SAAC

Actual Charged to Transportation Account:	$57,520.34
Total Charged to FMS Customers:	$29,747.98
Difference of Actual vs. Charged:	$27,772.36
Transportation Provided but Coded as No Trans Charge:	$17,521.81
Transportation Provided but No Bill Processed	$14,595.86

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